

High inflation not only due to high food prices

Jump in food prices determined the course of inflation in November...

Consumer prices rose 1.73% MoM in November, notably higher than the market consensus of 1.21% and our in-house forecast of 1.31%. Meanwhile, annual inflation rose to 9.48% from 7.66% in October. Food group prices rose 3.3% MoM, making a 0.9 pp contribution to monthly inflation. However, the inflation pressures were not confined to the food group as clothing group prices were up 5.6% MoM, visibly higher than the 3.4% average in the clothing group for the last five Novembers.

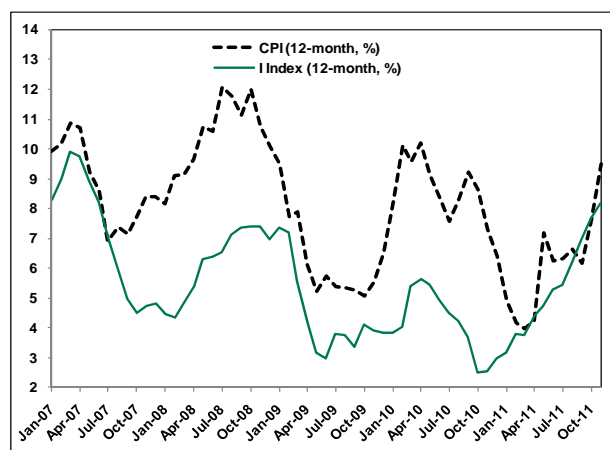
We forecast 10.1% year-end inflation...

Core inflation indicators affirm the fact that the jump in inflation is not only due to the surge in food prices and base effects. Monthly I group inflation, the CBRT's favorite core inflation indicator which excludes food, energy, tobacco products and gold came in at 1.2%, while annual I inflation increased to 8.2% from 7.7% in November. Recent inflation figures point to the fact that the deterioration in medium-term inflation expectations may not be a distant possibility unless there is a correction in inflation figures, which we do not foresee due to the low base of the first half of 2011. Barring a correction in food prices in December, annual CPI inflation seems to be ending the year at 10.1%, almost double the official target of 5.5% and above our 9.1% previous forecast. We forecast annual inflation to hover around 10% until the final quarter of 2012 before ending at 6.4% thanks to the favorable base created by special consumption tax increases and the surge in food prices in Q4 of this year.

Summary Inflation Data: November 2011
(in percent)

	Monthly		12-month	
	Nov 11	Nov 10	Nov 11	Oct 11
CPI	1.73	0.03	9.48	7.66
Food and Beverages	3.27	-1.89	7.11	1.76
Tobacco and Liquor	3.69	0.61	18.56	15.05
Clothing and Footwear	5.59	3.87	8.41	6.64
Housing	0.61	0.58	8.88	8.85
Houseware	1.15	0.61	11.09	10.49
Health	0.23	0.01	0.46	0.24
Transportation	-0.55	0.45	13.22	14.35
Communication	0.90	0.32	4.83	4.23
Entertainment and Culture	0.01	-0.81	5.92	5.05
Education	0.07	-0.14	6.62	6.40
Hotels, Cafes and Restaurants	0.62	0.87	8.01	8.28
Miscellaneous goods and service	1.69	0.76	19.14	18.05
PPI	0.65	-0.31	13.67	12.58
Agriculture	5.40	-4.25	5.25	-4.39
Industry	-0.25	0.63	15.54	16.56
o/w: Mining and Quarrying	0.18	0.33	21.77	21.96
Manufacturing Industry	-0.50	0.80	16.41	17.93
Electricity, Gas and Water	1.86	-0.77	6.28	3.53

Source: TURKSTAT



Source: TurkStat

No surprises from the MPC meeting

The CBRT's Monetary Policy Committee left the policy rate at 5.75% and the walls of the interest rate corridor unchanged at 5.00% for the O/N borrowing rate and 12.50% for the O/N lending rate, in line with the market consensus and our in-house forecast. In addition, the Committee did not provide any signal on potential reserve requirement changes as expected.

CBRT to adjust the amount of one-week repo funding when necessary...

Inflation will increase in December due to the base effects in unprocessed food prices according to the MPC. However, the bank expects inflation to decline gradually next year and approach the 5% inflation target in the final months of 2012. As in the announcement from the November meeting, the MPC believes that the conditional monetary tightening which started in October will prevent any secondary effects of the recent rise in inflation as the growth in domestic demand will follow a moderate course in the upcoming period. Tight monetary policy should be continued to keep the inflation outlook in line with medium-term targets, said the MPC. However, the Committee added that monetary policy flexibility should be maintained due to uncertainties in the global economy. In this respect, similar to the November announcement, "the impact of measures taken on credit, domestic demand, and inflation expectations will be monitored closely and the amount of Turkish lira funding via one-week repo auctions will be timely adjusted on both sides, if needed."

Economic activity accelerates in third quarter contrary to expectations

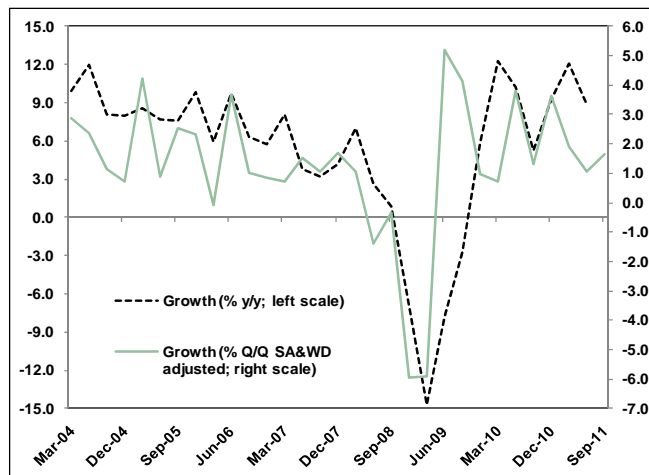
Economic activity accelerated in the third quarter...

Real output grew by 8.2% YoY in the third quarter, higher than the market consensus of 6.7% and our in-house forecast of 7.3%. Adjusted for seasonal and calendar effects, economic activity accelerated as output rose by 1.7% QoQ following 1.1% growth in the second quarter. Year-to-date, economic activity surged by 9.6% YoY following the 9.0% growth figure of 2010. Also, first quarter growth was revised up to 12.0% YoY from 11.6%, which takes first half growth slightly up to 10.4% from 10.2%.

Growth rate for 2011 will likely exceed 8%...

The contribution of net external demand turned positive in Q3 thanks to the rebalancing in economic activity. Net external demand made its first positive contribution to growth (0.6 pp) since Q3 2009 as the exports under GDP rose 10.8%, higher than the 7.3% in imports. Meanwhile, domestic demand made a 9.3% contribution to the Q3 growth figure, while stock changes erased 1.6 pp off the headline figure.

We revised our GDP forecast up to 8.2% after the Q3 figures. The annual growth rate for 2011 seems like it will exceed 8% according to our forecasts. After the Q3 growth figures, we revise our growth forecast for this year up to 8.2% from 7.5%, but keep our 2012 forecast unchanged at 1.0%.



Source: Turkstat

October's current account deficit notably below the market consensus

Cumulative current account deficit is near its peak...

At USD 4.2bn, October's current account deficit came in below the market consensus (USD 4.8bn) and our in-house forecast (USD 4.7bn). The current account deficit was USD 3.3bn in October last year. The monthly deficit figures took the 12-month rolling deficit to USD 78.6bn, which widened by USD 0.8bn over September. Our forecast error in the CAD forecast was due to the income item which improved USD 0.3bn over October 2010.

We forecast a USD 78bn current account deficit this year...

The adjustment in the non-energy current account deficit began in October when the monthly non-energy current account balance turned positive for the first time since February last year, posting a surplus of USD 0.2bn. In 12-month rolling terms, it declined by USD 0.4bn to USD 33.1bn. Although it is a development within a month, we expect this to continue in the upcoming period due to the slowdown in imports in seasonally adjusted terms.

Official reserves shouldered the financing burden in October. The short-term nature of external financing remained unchanged in October as net FDI remained weak at USD 0.3bn compared to USD 0.8bn in October 2010, while net portfolio inflows was USD 1.2bn. In October, the main financing item was official reserves which declined USD 3.7bn, while there was an inflow of USD 0.9bn under net errors and omissions.

We forecast a CAD of USD 78bn (10.2% of GDP) this year before it will narrow down to USD 59bn (7.4% of GDP). However, the pressure on the lira will remain as financing prospects in 2012 are not rosy as we expect the rollover ratio for MLT debt to decline to around 80% in 2012.

**Current Account Developments
(in millions of US\$)**

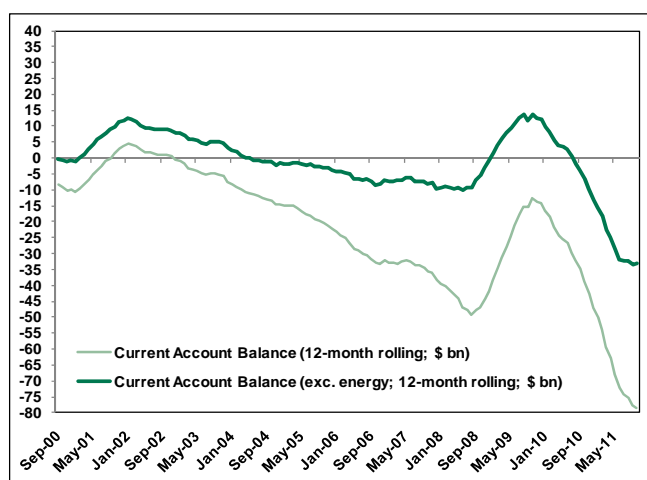
	Oct		12-month rolling	
	2011	2010	Oct	Sep
Current Account	-4,151	-3,335	-78,611	-77,795
o/w: Non-Energy 1/	220	-142	-33,079	-33,441
Trade Balance	-6,461	-5,022	-90,248	-88,809
Exports	12,782	11,545	140,809	139,572
%	11	7	225	222
Imports	-19,243	-16,567	-231,057	-228,381
%	16	37	463	484
Services (net)	2,708	2,338	18,167	17,797
o/w: Tourism (net)	2,567	2,262	18,449	18,144
%	13	8	214	208
Income (net)	-477	-824	-8,047	-8,394
o/w: Interest Expenditure	-413	-427	-5,090	-5,104
Current Transfers	79	173	1,517	1,611
Memorandum Items: 2/				
Trade Balance	-7,980	-6,333	-106,671	-105,025
Energy 3/	-4,371	-3,193	-45,532	-44,354
Non-Energy	-3,609	-3,140	-61,139	-60,670

1/ Current account less energy deficit by TURKSTAT definition, i.e. energy imports including cost-insurance-freight.

2/ TURKSTAT definitions.

3/ STIC definition; including crude oil, petroleum products and natural gas.

Source: CBRT

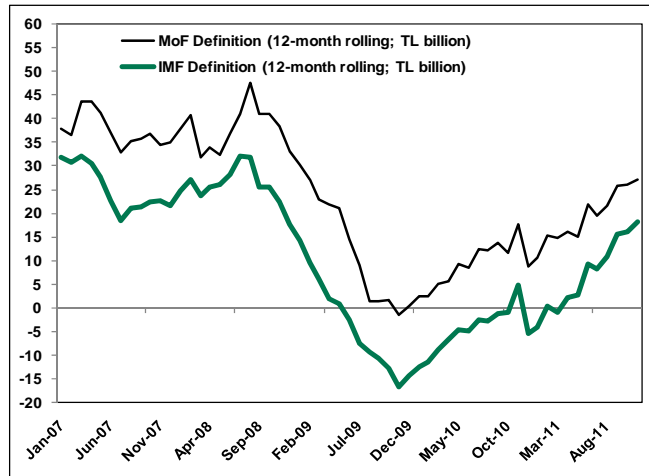


Source: CBRT

Favorable budget thanks to lower interest expenditures and additional revenue from restructuring

Budget deficit and primary surplus will end the year at 1.1% and 2.2% of GDP respectively...

The central government budget posted a surplus of TRY 2.1bn and a primary surplus of TRY 5.7bn in November. The headline figures seem to have improved at first sight as the budget posted a deficit of TRY 0.4bn and a primary surplus of TRY 4.6bn in November 2010. However, taking into account the TRY 1.4bn revenue collection from debt restructuring and TRY 1.5bn less interest payment in November this year, the budget balance would not be favorable compared to November of last year. For January-November, the central government budget registered a budget deficit and primary surplus of TRY 0.4bn and TRY 41.4bn respectively. The central government budget deficit and primary surplus will end the year at 1.1% and 2.2% of GDP respectively according to our forecasts. These figures are favorable compared to the revised budget targets (budget deficit: 1.7% of GDP and primary surplus: 1.6% of GDP). For 2012 we forecast the budget balance and primary balance at -2.5% of GDP and 1.1% of GDP respectively, lower than the government targets by nearly 1% of GDP as we expect the 2012 growth rate to be realized at 1%, lower than the government forecast of 4%.



Source: Ministry of Finance