

**CPI inflation surged in May, but it will likely to correct in June**

Highest monthly inflation on record in May since 2001...

Monthly CPI inflation came in at 2.42% in May, significantly exceeding the market consensus (1.08%) and our in-house forecast (0.90%). This is the highest monthly print recorded in May since 2001. This outcome brought annual inflation to 7.17% from 4.26% in April. While some part of the increase is due to the low base of May 2010, most of it came from the high monthly rise in consumer prices.

Core inflation indicators are still below the CBRT's inflation target for 2011, which is at 5.5%...

Food prices rose 4.71% MoM as the main contributor to monthly inflation with 1.25 pp due to very high cherry and plum prices. The clothing group was the second highest contributor with an 11.68% MoM change and 0.84 pp contributions due to seasonal price hikes. The contributions of other groups were not significant.

While all of the annual core inflation indicators rose in May compared to April, the most preferred price gauges of the CBRT displayed only moderate rises. The most closely followed core inflation indicator, the I index, which excludes food, beverages, energy, tobacco and gold, showed a slow increase relative to the rise in the headline. Annual I index inflation rose to 4.72% from 4.42% in April. On the other hand, annual H index inflation rose 5.14% from 4.81%. They are still below the CBRT's inflation target for 2011, which is at 5.5%.

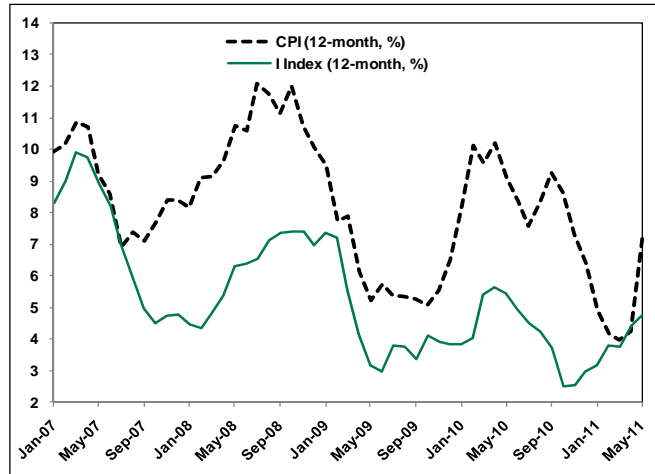
We expect a downward correction in food prices in June and July...

We do not change our year-end inflation forecast (7.6%) yet, as we expect a downward correction in food prices in June and July. Food prices and possible price hikes in utilities such as electricity, will determine the course of inflation this year. However, it seems that the CBRT's 5.5% inflation target and 6.9% inflation forecast are optimistic at this point.

Summary Inflation Data: May 2011  
(in percent)

	Monthly		12-month	
	May 11	May 10	May 11	Apr 11
<b>CPI</b>	<b>2.42</b>	<b>-0.36</b>	<b>7.17</b>	<b>4.26</b>
Food and Beverages	4.71	-4.38	12.61	2.83
Tobacco and Liquor	-0.01	-0.01	-1.51	-1.51
Clothing and Footwear	11.68	11.16	6.23	5.74
Housing	0.54	0.39	5.02	4.86
Houseware	0.26	0.15	7.40	7.28
Health	0.11	-0.02	0.70	0.57
Transportation	0.63	-0.03	8.69	7.98
Communication	-0.47	-1.34	-0.29	-1.16
Entertainment and Culture	0.99	-0.46	-0.20	-1.63
Education	1.14	0.60	5.19	4.64
Hotels, Cafes and Restaurants	0.81	0.90	7.20	7.30
Misc. goods and services	1.47	1.97	7.68	8.21
<b>PPI</b>	<b>0.15</b>	<b>-1.15</b>	<b>9.63</b>	<b>8.21</b>
Agriculture	-1.93	-5.66	8.73	4.59
Mining and Quarrying	0.84	2.82	14.00	16.24
Manufacturing Industry	1.16	-0.31	11.27	9.65
Electricity, Gas and Water	-4.47	1.13	-3.40	2.26

Source: TURKSTAT



Source: Turkstat

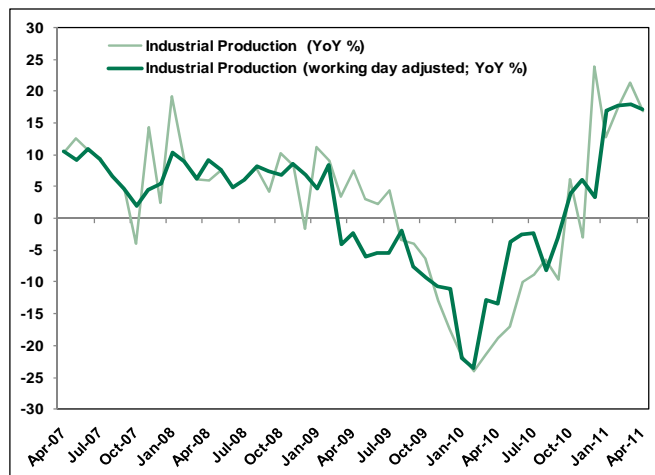
**IP figures also give signs of a slowdown**

After the 10.2% YoY rise in March, industrial production rose 8.3% YoY in April, lower than the 9.1% market consensus and our forecast of 9.8%. On the other hand, in working day and seasonally adjusted terms, IP edged down 0.6% MoM in April after the contractions in February (-1.8% MoM) and March (-0.5% MoM).

April IP figures are positive for the current account deficit outlook as they imply a slowdown...

Looking into the details, capital goods and intermediate goods manufacturing slowed down in April. The former grew 21.7% YoY in April compared to 26% YoY recorded in March, while the latter expanded 6.0% YoY, slowing from 7.0% YoY in March. In addition to the PMI index for May (50.6), which pointed to the weakest expansion in the manufacturing sector since September, the developments in capital and intermediate goods production in April support the fact that the economy may have slowed down in May.

We find the IP figures positive for the current account deficit outlook, even though it is below the market consensus, as the figures point to a slowdown in the economy.



Source: Turkstat

**PMI for May points to the weakest expansion in manufacturing since September**

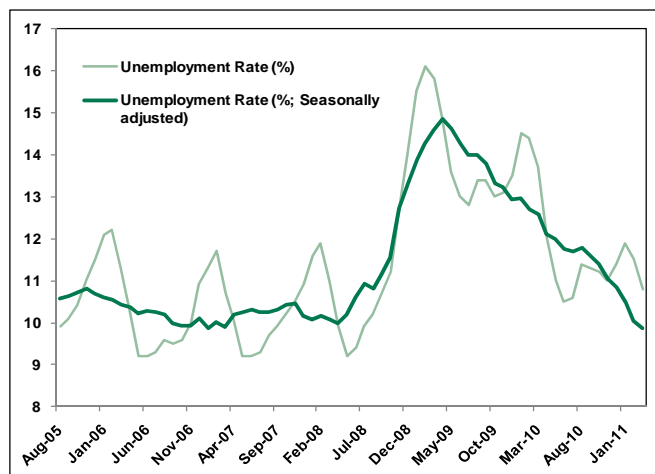
The PMI is at the lowest level since September...

The PMI index for Turkey implies a slowdown in the expansion of the manufacturing sector in May after the slowdown in April. The index declined to 50.6, which is the lowest level since September, while it still points to an expansion as it is above the 50 mark. The loss of momentum in manufacturing production may have stemmed from the measures taken by the economic administration since December against the current account deficit. However, we should still see more indicators to be convinced about the effectiveness of the monetary policy against the high credit growth and hence the current account deficit.

**Unemployment rate declined further in March**

Unemployment rate is at pre-crisis levels...

TurkStat announced the unemployment rate for March at 11.0%, 2.6 pp lower over March 2010. (February: 11.5%). On the other hand, the seasonally adjusted unemployment rate improved, albeit with a slower pace, to 9.87% from 10.05% in February. We expect the decline in the SA unemployment rate to slowdown further after March, as the PMI indices show that the expansion in the manufacturing sector slowed significantly.



Source: Turkstat

**Widening in the current account deficit continues**

In April, the widening in CAD was mostly due to the expansion in the non-energy component...

The CBRT disclosed April BoP figures today, with the current account balance posting a deficit of USD 7.7bn, broadly in-line with the market consensus (CNBC-e survey: USD 7.8bn). Accordingly, the 12-month rolling deficit widened to a new record - USD 63.4bn from USD 60.1bn in March. In addition, the widening was mostly due to the expansion in the non-energy CAD from USD 23.1bn to USD 25.7bn in April.

On the financing front, the economy attracted USD 9.2bn in net financial inflows in April, of which USD 1.2bn increased official reserves at the CBRT. While net FDI remained weak at USD 0.6bn, the bulk of the inflows came to bonds in April. The domestic Treasury papers attracted USD 3.9bn. In addition, bank bonds got USD 0.9bn in April as the equities got USD 0.8bn.

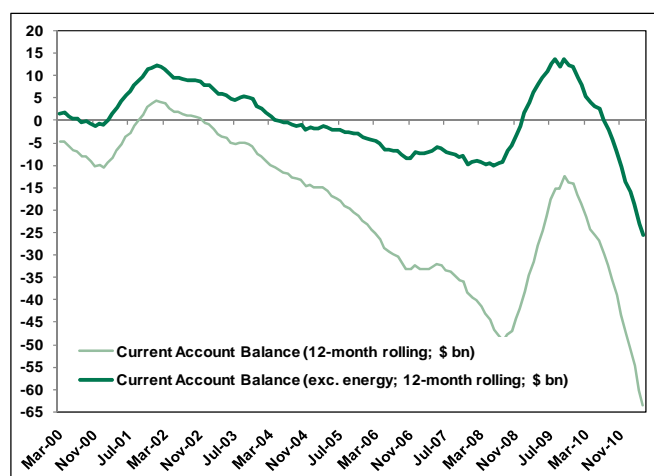
CAD was financed with short-term inflows once again in April...

On the other hand, local banks brought USD 3bn in deposits to Turkey from their correspondent bank accounts abroad, while foreigners deposited USD 1.6bn to local banks in April. On the other hand, the medium to long term borrowing by banks and non-bank sectors continued their positive performance. Banks and non-bank sectors used USD 0.5bn and USD 0.2bn in net MLT credits in April, but with lower rollover ratios. The rollover ratios for banks and non-bank sectors were 184% (March: 218%) and 113% (March: 190%) respectively.

The market participants are waiting for more steps from the new government to solve the record CAD...

The net errors and omissions item normalized in April with a USD 78mn outflow after a USD 4bn inflow in January-March.

After the market friendly election outcome, market participants are waiting for more steps from the new government to solve the record current account deficit, which we forecast to realize at USD 66.5bn (8.5% of GDP) by year end.



Source: CBRT

**Central government budget registers a TRY 2.8bn budget surplus and TRY 6.9bn primary surplus in May.**

While the central government budget was in positive territory in May, the results compare unfavorably with May 2010 (budget balance: +TRY 5.8bn; primary balance: +TRY 8.0bn). The positive results in May were the result of an improvement in tax revenues (up 19.1% YoY to TRY 23.3bn), while primary expenditures increased 19.8% YoY to TRY 20.2bn. The higher revenue and primary expenditure mix continued in May, which shows that there is space for some tightening on the fiscal side in order to support measures by the CBRT against the current account deficit.

There is space for some tightening on the fiscal side against the CAD...

**Central Government Budget: 2010-2011  
(in billion TL)**

	May		Real growth (%)
	2011	2010	
Central Government Revenues	27.1	24.9	1.8
o/w: General Budget Revenues	26.4	24.2	1.6
Tax Revenues	23.3	19.6	11.1
o/w: Corporation Tax	9.0	7.9	6.9
Tax on Income	5.0	4.8	-1.3
Tax on Goods and Services	8.0	7.6	-1.1
o/w: VAT	2.2	2.2	-7.5
SCT	5.1	4.7	0.2
Tax on Foreign Trade	4.7	2.9	48.4
Non-Tax Revenues	3.8	5.3	-32.5
Central Government Expenditures	24.3	19.1	19.0
Non-Interest Expenditures	20.2	16.9	11.8
o/w: Personnel	6.9	6.0	8.2
Government Prem. to Social Security Agen.	1.0	0.9	7.9
Good and Services Procurements	2.3	2.1	1.0
Capital Expenditures	1.8	1.4	14.7
Current and Capital Transfers	8.9	7.1	17.1
o/w: Social Security	3.2	3.6	-16.9
Transfers to Households	0.1	0.1	160.0
Agricultural Subsidy	1.3	0.6	90.5
Treasury Aid to Provincial Offices	0.2	0.1	70.1
Interest Expenditures	4.1	2.2	75.2
Overall Balance	2.8	5.8	...
Primary Balance	6.9	8.0	...

Source: Ministry of Finance