

Annual inflation at ~9% with highest MoM reading of the past 9 months...

Oct14 CPI: +1.9% MoM (market expectations: 1.78%, Seker Invest forecast: +1.5%)

Oct14 DPI: +0.92% MoM

In October CPI of 1.9% MoM exceeded market expectations. With the print, annual CPI rose to 8.96% from 8.86% recorded in September. Annual DPI inflation also increased to 10.10% from 9.84%.

Annual inflation hovering at 9%...

Regarding the details of the CPI print; in October, food prices with a 2.65% MoM rise posted the Ytd second highest MoM rise after Jan14. As of October, annual food inflation is at 12.56% (Ytd 12.45%), significantly above headline inflation.

With seasonal effects, clothing and footwear posted 9.95% MoM increase implying ~70 bps on the headline. In October, housing and rent was another sub-item that brought remarkable pressure due to 9% energy price adjustments implemented as of October.

As for the core indices closely monitored by the CBT, core H and core I posted 1.48% and 1.57% MoM increases in October. Although some softening in core indices is observed for the second consecutive month; core H annual inflation is still at around 10% (9.83%) and core I annual inflation is at 9.04%, doubling the CBT's medium-term inflation target of 5% and still above 2014 YE revised inflation forecast of 8.9%.

Comment:

As of October, with the highest MoM reading of the past 9 months, Ytd CPI reached 8.45% and YoY inflation was realized at 8.96%. October is seasonally a high inflation month as energy price hikes are often implemented then.

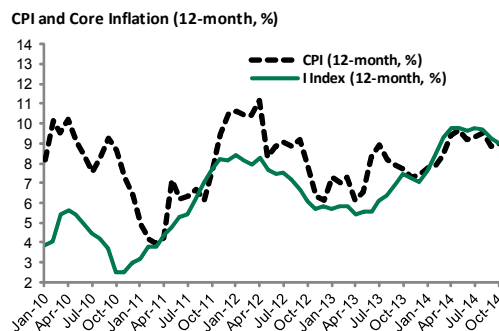
Additionally, food prices mostly do not support headline inflation due to adverse weather conditions. Following the above-expectations CPI reading of October, we expect November and December months to post moderate MoM rises, ending the year at around the 8.5% to 9% range.

However, we can see annual inflation increasing in November due to the base year effect. On October 31, the CBT revised its 2014 YE inflation forecast from 7.6% to 8.9%, mainly due to higher than expected inflation in food prices and worsening pricing behavior. Our 2014 YE inflation forecast stands at 8.8%.

Regarding monetary policy, as of September, the MPC has halted the easing cycle both on rising lira volatility and the disappointing performance on the inflation front.

During the inflation report presentation, the Governor stated that there had been some moves from the government side regarding food prices that they expected to pay off in the coming period, adding that a tight monetary stance would be preserved till a remarkable recovery in price dynamics was observed.

For the coming period, with significant revision to YE inflation figures, and especially the unignorable effect of worsening pricing behavior by around 70 bps, we expect the MPC to sustain the currently tight monetary policy, or even shift onto a tighter path, depending on global financial conditions. As such, the schedule regarding the conditions of the Fed's interest rate policy will be the determinant factor.



September IP performed better than expectations...

Turkstat has released the Sep14 IP print, wherein the IP index posted 4.1% YoY growth. The market expectation and Seker Invest forecast had been at 3.7% and 2% YoY growth, respectively. Seasonality and calendar-effect adjusted (SCE) IP posted 1.7% MoM growth in September, marking the Ytd strongest performance. Yet, we should not forget that August SCE posted the weakest performance on 1.1% MoM contraction.

September IP at 4.1% performed better than expectations...

In the details, “manufacture of other transport equipment” was the key contributor to the headline print on 100% YoY growth (75 bps contribution) followed by the “manufacture of basic pharmaceutical products” sub-item on 17% YoY growth (54 bps contribution). The third contributor was “wearing apparel” on 5.4% YoY growth followed by “textiles” on 4% YoY growth (48 bps contribution).

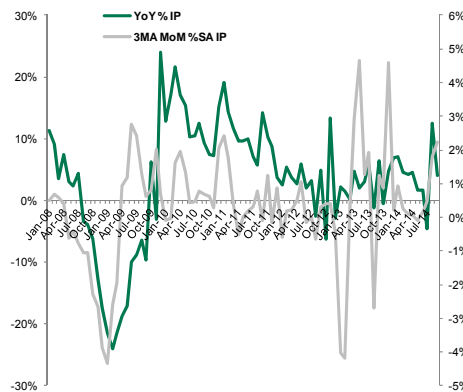
Comment:

After August’s 12.5% YoY increase mainly underpinned by the base-year effect, IP posted 4.1% YoY growth in September, above the market expectation and Seker Invest forecast. SCE posted its YtD strongest performance in September. Yet while September IP shines a ray of hope regarding economic activity, it is too early to talk about a strong domestic revival. Remember that in particular as of May14, we observe a weakening in IP numbers contrary to the expectations of acceleration in domestic activity following the Mar14 local elections.

For the coming period, August (12.5% YoY growth) and September (4.1% YoY growth) pulled 3Q14 average annual IP growth to 4% from the 2Q14 average annual IP growth of 2.6%, implying GDP growth in a range of 3% to 3.5%.

Although 3Q14 GDP growth is likely to be stronger than 2Q14 GDP growth of 2.1%, we believe that it is too early to be convinced of a long-awaited recovery in domestic demand. Furthermore, uncertainty regarding global liquidity conditions still prevails. Accordingly, we keep our 2014YE GDP growth forecast at 3%, vs. the government’s revised GDP growth forecast of *3.3%.

* The Government revised down 2014&2015 GDP growth forecasts from 4% to 3.3% and from 5% to 4%, respectively in the 2015-2017 Medium Term Economic Plan.



Weakness in tax revenues continued in October...

- Oct14 budget balance: TRL3bn of deficit (Oct13 balance: TRL3.2bn of deficit)
- Oct14 primary balance: TRL4bn of surplus (Oct13 balance: TRL0.8bn of deficit)
- Jan-Oct14 budget balance: TRL14.9bn of deficit (Jan-Oct13 balance: TRL7.7bn of deficit)
- Jan-Oct14 primary balance: TRL30.3bn of surplus (Jan-Oct13 balance: TRL38.6bn of surplus)

Recovery in tax revenues has not been observed yet...

With October’s results the Jan-Oct14 budget deficit doubled to TRL14.9bn from the Jan-Oct13 level of TRL7.7bn, while the primary surplus also weakened to TRL30.3bn from the Jan-Oct13 level of TRL38.6bn.

In the details, after a slight recovery in the Jul-Aug14 period, bleeding in tax revenues continued in October with a 1% YoY real contraction, reflecting still weak domestic demand.

“Value added tax” posted its worst YtD performance on 23% YoY real contraction, while “special consumption tax” and “import tax” could not support the headline tax revenues on flat YoY real growth. “Non-tax revenues” and “other revenues” helped headline revenues, pulling YoY real growth in revenues to 5% from September’s YoY real contraction of 7%.

On the expenditures front, after September’s eye-catching YoY real rise of 12% in non-interest expenditures, this item contracted 10% in October. However, in the details, we see that social security payments, main reason behind the decline in “non-interest expenditures”, contracted by around 30%, which is likely to be reversed in the November-December period. On the other hand, with the heavy interest payments, headline expenditures posted a 3% YoY real increase in October period.

As for the Jan-Oct14 period, tax revenues contracted 1% in YoY real terms. Consumption-related tax sub-items, i.e., value added tax (9% YoY real contraction), special consumption tax (4% YoY real contraction) and import tax (4% YoY real contraction) were the worst performers. Meanwhile, “other revenues” including privatization receipts and Treasury affiliates were strong on 19% YoY real growth.

Regarding expenditures; for the Jan-Oct14 period, YoY real rises in non-interest expenditures realized at 4%. The sub-items to have surpassed headline growth were; personnel expenditures (6% YoY real rise), capital expenditures (6% YoY real rise), other current expenditures (6% YoY real rise) and goods and services (5% YoY real rise).

Comment:

In the recently published Medium Term Program, the Ministry of Finance revised down the 2014 YE budget deficit forecast from TRL33.2bn to TRL24.4bn, and the primary surplus forecast from TRL18.8bn to TRL25.8bn. As of October, the budget deficit reached TRL14.9bn, while the primary surplus amounted to TRL30.3bn. Accordingly, even considering the seasonal rise in expenditures in December we do not foresee a major shift in budget deficit and primary surplus projections for 2014YE.

No change in interest rates....

The MPC held all interest rates constant at its November meeting parallel to the market consensus and Şeker Invest forecast for the third consecutive month. Apart from the mention of domestic demand the statement was more or less a carbon copy of October’s note.

MPC kept its tight stance in November meeting...

-With the slowdown in global demand, domestic demand is mentioned giving greater support to growth. In October’s note, despite weakening global demand, exports were expected to continue supporting GDP growth. Yet in November’s meeting note, there is no mention of exports’ support of headline growth.

-In the note, it was repeated that the positive impacts of macro-prudential measures taken at the beginning of the year, and the tight monetary stance, were clearly observed in core indices. However, food prices curb improvement in the inflation outlook. For the coming year, the falling trend in commodity prices will likely support the decline in inflation.

-Inflation expectations, pricing behaviour and other factors affecting the inflation outlook will be monitored closely and a tight monetary stance will be kept until there is a definite improvement in inflation dynamics.

Comment:

Although there were some expectations of a symbolic cut with relief from the commodity front, the market was mostly tilted toward a “no cut” expectation. November’s meeting seems to be “no news” for the market, as it was a consensus call that the MPC would keep all rates on hold, we believe it was a crucial meeting in terms of gauging the MPC’s stance.

As such, it is relieving for us and for the market as we understand from lira’s recovery following the decision to see that the MPC is not hurrying, and likely to move cautiously as we have seen no signals of easing from the statement for the near future. Furthermore, replacing domestic demand with exports as a supporter to headline growth signals the comfort with the current monetary policy framework.

All in all, we observe via a halting of the easing cycle and macro-prudential tools, the MPC preparing for the challenging period ahead, which will be shaped by the major global central banks, especially the FED.