

**CPI inflation ends the year at 8.2%...**

Dec14 CPI: -0.44% MoM (market expectations: +0.06%, Seker Invest forecast: +0.10%)

Dec14 DPI: -0.78% MoM

With the lower than expected MoM increase in CPI, annual CPI declined to 8.17% from 9.15% recorded in November. With the negative December reading, annual DPI inflation declined to further to 6.34% from 8.36%.

**CPI at 8.2% , remarkably higher than CBT's %5 target...**

Regarding the details of the CPI print; in December, the softening in food prices continued with a flat MoM reading supporting the headline. Ultimately, despite two months of softening in food prices, annual inflation realized at ~12.8% as of 2014 YE, remarkably above the 2014 YE headline inflation.

Apart from food, with declining oil prices, transport posted a 1.8% MoM decline for the second consecutive month. With consecutive drops, annual inflation in transport fell to 2.1%.

As for the core indices closely monitored by the CBT, MoM declines in core H and core I were less than the fall in headline CPI, at 0.26% and 0.38% respectively. As for the annual trend, not as strong as the fall in headline, annual core H and core I also fell to 9.55% and 8.73% from 9.89% and 9.03%, respectively. Accordingly, core indices' annual inflation finished the year far off the CBT's medium-term inflation target of 5%.

**Comment:**

In December, CPI stayed below expectations at -0.44% MoM. With a flat MoM reading in food prices, the declining trend in transport prices on the back of falling oil prices and the support of the base year, which will be much more pronounced over the coming months, annual inflation fell from 9.2% to 8.2%, staying below the CBT's revised forecast of 8.9%. Yet, it is still far off CBT's target of 5%.

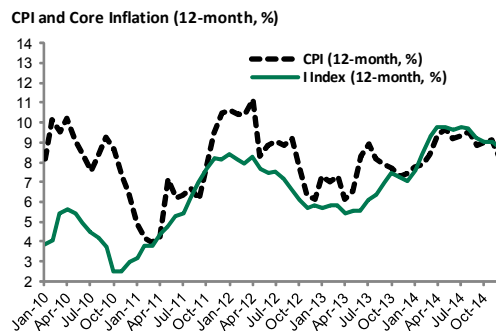
In the details, food ranks the number one contributor to headline inflation in 2014 followed by housing&rent and hotels&restaurants as a consequence of food inflation and a weak lira. Although food inflation is an undeniable pressure on headline inflation, we believe it is not fair to put the blame on food alone, as the core indices have been hovering at around 9% to 10% since March.

2014 YE inflation fell to 8.2% from 9.2% with the support of the above-mentioned factors, and as of 1Q15, mostly due to the base year effect and partly due to vanishing pressure of pass-through effects, this together with the support of fall in oil prices, we will see the falling trend in annual inflation continue.

It is the common view that this picture will likely relax the hands of MPC to ease monetary conditions in support of economic activity ahead of general elections.

However, as we experienced throughout 2013HY and 2014FY, volatility in the currency is crucial in investment/consumption decisions, hampering GDP growth significantly, perhaps more than "high" interest rates.

For 2015 our YE CPI forecast is 8%.



Source: TURKSTAT

**Weakness in IP accelerates in November...**

Turkstat has released the Nov14 IP print, wherein the IP index posted 1.2% YoY contraction. The market expectation and Seker Invest forecast had been at 0.2% and 3% YoY growth, respectively. Calendar effect adjusted IP posted 0.7% YoY growth in November.

Seasonality and calendar-effect adjusted (SCE) IP posted 0.2% MoM contraction in November for the second consecutive month.

**In the first ten months of the year, IP grew %3.6 on average YoY...**

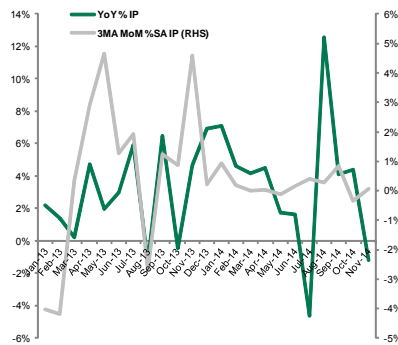
In the details, “basic metals” emerged as the worst performer at 8.2% YoY contraction, stealing ~76 bps from the headline. The second worst performer is “textiles” on 3.7% YoY contraction shaving off ~43 bps from the headline. “Fabricated metal products” also performed weakly contracting 8.9% YoY (36 bps pressure on the headline). Apart from “manufacture of pharmaceutical products” that contributed 40 bps to the headline print, all the main sectors posted YoY contractions in November.

As might be recalled, despite the base year effect, October’s figure, at 4.4% YoY growth, was short of expectations. We had already perceived the signals of a weak November figure from October’s print.

However, the November figure came in remarkably below expectations at 1.2% YoY contraction. To clear off the data from the base year effect, which will remain a drag on IP in December, we look at SCE. Yet, the print does not imply any recovery in economic activity as the MoM contraction continued for the second consecutive month, as well. Accordingly, the main indicator of GDP growth performs weakly in 4Q14.

As of November, for the IVQ, we do not get any convincing signals of a recovery in economic activity as the average YoY growth in IP for Oct-Nov14 period is 1.6%, thus below Oct-Nov13 average YoY growth of 2.1%.

Furthermore, as we mentioned above, Dec14 IP might not be strong either, due to both the base year effect and still-anemic domestic economic activity. Accordingly, we keep our 2014 and 2015YE GDP growth forecast at 3%, vs. the government’s revised GDP growth forecast of 3.3% and 4%, respectively.



Source: TURKSTAT, Seker Invest

**Temporary rise in the rolling deficit with gold imports...**

Jan-Nov14 CAD: USD38.7bn (Jan-Nov13 CAD: USD56.7bn)

12mth rolling CAD: USD47.1bn UP from USD45.7bn

2013 YE CAD: USD65bn

**CAD reached USD38.7bn with 32% YoY contraction in Jan-Nov14...**

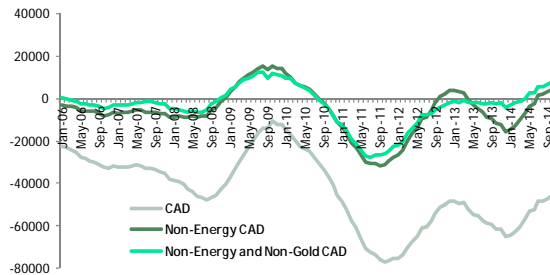
November’s current account deficit (CAD) of USD5.6bn (34% YoY rise), realized slightly above market expectations of USD5.2bn. Seker Invest’s forecast was for an USD6.3bn deficit. With this print, contraction in the 12mth rolling deficit halted, and as we mentioned in our October note, rolling CAD increased to USD47.1bn from USD45.7bn. The main reason behind the rise in the CAD was gold imports of USD2.1bn which is the highest figure since the Apr13-Jun13 period.

On the financing front; in November, capital inflows realized at USD9.9bn, marking the highest level since Apr13. In the details, with expectations of rate cut moves from the MPC, foreign interest in government debt instruments continues in November as in Sep-Oct14, at USD2.3bn.

The second supporter on the financing front was “corporates” with USD2.4 of net borrowing. Banks ranked third in November at USD1.5bn. Meanwhile, outflow from net errors&omissions continued at USD3.4bn.

**Comment:**

For 2014 the government’s CAD forecast is USD46bn (5.7% of GDP). Meanwhile, the fall in oil prices, 2014 CAD may even slide below that projection. However, we should consider, too, that the fall in oil prices also reflects the slowdown in global GDP growth, which may yet prove to be a drag on export performance in the coming period. The fall in oil prices and the anemic demand will likely push CAD to levels below USD50bn, CAD/GDP is still hovering around 6%. That Picture reminds us the necessity of structural reforms once again.



**The MPC has not waited...**

After four months of “wait and see” mode, the MPC cut 1 week repo rate 50 bps to 7.75%, above the market consensus of 25 bps cut while keeping the upper and lower band of the corridor. The first paragraph of the statement on the macroeconomic outlook is a carbon copy of December’s note; moderate growth in loans and improvement in terms of trade will continue to support recovery in the current account deficit, and domestic demand is mentioned giving greater support to growth, versus the slowdown in global demand.

**MPC is expected to take further moves in the coming period...**

Regarding the inflation front; it was repeated that the positive impact of macro-prudential measures taken at the beginning of the year, and the tight monetary stance, were clearly observed in core indices. The only difference from the December note was the statement that the positive effects of those measure and tight monetary policy were seen in inflation expectations, as well. The relief from the falling trend in commodity prices on inflation was once again mentioned. Accordingly, recovery in inflation expectations seems to be the main driver behind the cut in 1 week repo rate, as the rest of the summary note more or less resembles December’s.

**Comment:**

As we had put the title of “Tilted towards easing” to our December note, the MPC was more concentrated on the positive factors that will support the falling trend in inflation in the December meeting note, paving the way for cuts. However, although domestic factors and the dovish statement from the Fed gave some comfort to the MPC, we had stated that the probability of the Fed’s bringing the tightening forward depending on the strength of the US economy and the currently dormant geopolitical risks should not be overlooked.

As such, we expected the MPC to take some steps towards easing towards the middle of 1H15. However, the move was earlier and bolder than we and the market had anticipated, which carries the risk of being seen as an “accelerated process” due to strong suggestion from the government. For the coming period, as long as global liquidity conditions and commodity prices permit, as a second step, we may see the MPC adjusting the upper and lower bands of the corridor which will be evaluated as a stronger easing from the Bank.