Annual CPI stayed at 6.6% in May…

May16 CPI: 0.58% MoM (Market expectations: 0.7%, Seker Invest forecast: 1%)
YoY CPI: 6.6% FLAT
May16 DPI: 1.48% MoM increase
YoY DPI: 3.25% UP from 2.87%

Ytd inflation reaches 3.15%...

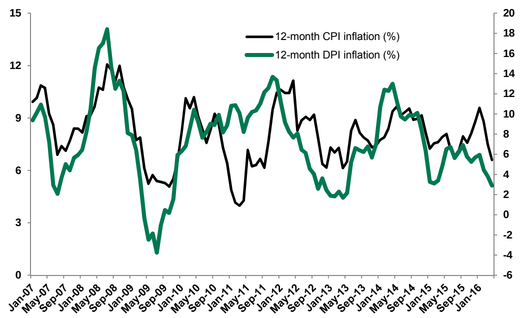
As was the case in February to April, food prices, on a 1.6% MoM fall, emerged as the main factor behind the lower than expected May realization. Due to base year effect, annual inflation slightly increased to 2.5% from 1.4%. As for the coming period, despite the currently soft figure, due to high volatility in food prices, the CBT kept its 2016 food inflation forecast at 9% in the last inflation report released at the end of April to be on the safe side.

Apart from food, none of the main details could support the headline. For example, clothing&foodwear posted an 8% MoM rise putting 60bps of pressure on the headline. Additionally, transport posted 1.10% MoM increase, still pressuring the headline.

We still observe stickiness in the details of the core indices closely monitored by the CBT. Accordingly, core H and core I posted MoM increases of 1.20% (prev: 1.68%) and 1.36% (prev: 1.94%), respectively. In May, annual core H and annual core I declined to 8.69% (prev: 9.21%) and 8.77% (prev: 9.41%), respectively.

Comment:

After the lofty start to the year at 9.6%, marking the highest start since 2012, mainly fueled by food prices, CPI stayed at 6.6. Meanwhile, the core indices are still hovering around 9%, reflecting stickiness in the details. Apart from food prices, which are the most volatile item, we do not observe a material improvement in the CPI details. Although there may be some downwards risks to our forecast, we prefer to keep our 2016 YE forecast at 10%.
In terms of monetary policy, as may be recalled, at its March, April, May and June meetings, the MPC cut the upper band by 175 bps and at the last inflation report presentation, the CBT's newly-appointed Governor Cetinkaya stated that the Committee targeted a "simpler and more foreseeable" approach. The main determinant to pave the way for such a shift in policy will be the degree of global volatility, on top of the inflation outlook. As such, we expect the Committee to continue with 25 or 50 bps steps at its July meetings as long as global and domestic conditions remain supportive. Thus, keeping the current policy rate at 7.5%, we believe the Committee targets a corridor with a lower band of 6.5% and upper band of 8.5%, before shifting to a single policy rate between 7.5% to 8%.



Loss of steam in IP in April…

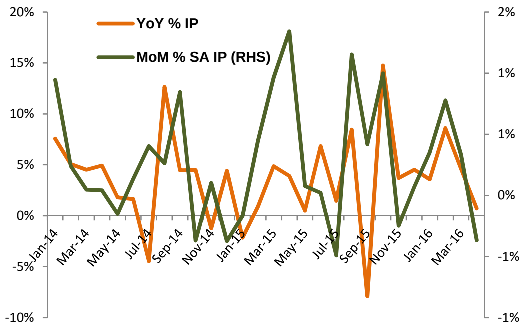
Turkstat has released its Apr16 IP print, wherein the IP index posted 0.6% YoY growth. Meanwhile, calendar-effect-adjusted (CEA) IP posted 0.7% YoY growth for the month while seasonality and contraction in calendar-effect-adjusted (SCE) IP accelerated to 1.1% MoM from 0.5% recorded in March. After a strong growth in 1Q16, in April, we observe a loss of steam both on an unadjusted and adjusted basis.

IP posted 4.4% average YoY growth in Jan-Apr15 period…

In the details of headline IP, on the contrary to March data, in April, "manufacture of computer/electronics" on 40% YoY contraction was the main item that suppressed the headline. In March, it was the main contributor to the headline with 62% YoY growth and with ~140 bps. Second item that pressured the headline was the "automotive production" with 8.6% YoY contraction. The weak trend has been continuing in the automotive production since the beginning of the year. Apart from "textiles" and "wearing apparel", all the export-oriented and/or main industry sub-items were in red territory.

Comment:

As might be recalled, 1Q16 average YoY growth had reached 5.6%, versus the 1Q15 average growth of 1.2% with support of mainly base year effect. Therefore, seasonally and calendar-effect adjusted figures give a healthier picture, we believe. Accordingly, in March, seasonally and calendar effect adjusted IP posted 0.5% MoM contraction pulling down 1Q16 average MoM growth to 0.3%, versus 1Q15 average MoM growth of 0.9%. Yet, headline IP numbers are used for calculating GDP growth numbers, and 1Q16 average YoY growth of 5.6% implies around 4% to 4.5% GDP growth for 1Q16 which will be announced on 10th June Friday. However, April did not make a good start for 2Q16 which is partly due to base year effect when IP grew 3.8% in Apr15. Despite the weakness in April figures, considering the volatile nature of IP, for 2016, we keep our GDP growth forecast at 4%, mainly supported by domestic demand.



Headline successful, yet disappointment in the details continue…

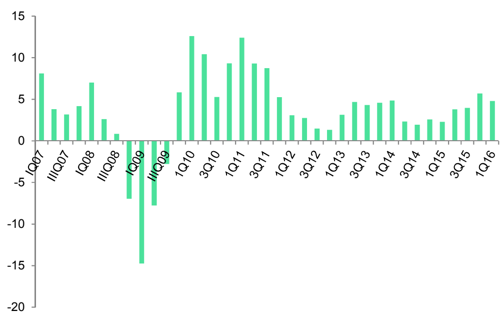
1Ç16 GSYH büyümesi: %4.8 yıllık, Şeker Yatırım beklentisi: %4.5 (Piyasa beklentisi: %4.4)
2016 yılsonu GSYH büyümesi piyasa beklentisi: %4.5
2015 yılsonu GSYH büyümesi: %4
Mevsimsellikten arındırılmış GSYH çeyreksel olarak %0.8 artış göstermiştir.

GDP growth above expectations in 1Q16…

In the details, private household consumption, at 6.9% YoY (480 bps contribution), emerges as the main contributor, followed by public sector with cumulative support of 120 bps. In 1Q16, net external demand shaved 150 bps off the headline due to a remarkable YoY increase in imports, resulting from Turkey's growth model.
As domestic demand recovers imports also rise. As such, imports saw growth of 7.5% YoY, marking the highest since 4Q13.In 1Q16, as in previous quarters, the main indicators of sustainable and healthy growth do not paint an encouraging picture, as the gross capital formation of the private sector was in red territory by 0.3%.

Comment:

In 1Q16, GDP grew 4.8% with private household consumption and public support, while net external demand and private investment could not support the headline. That picture was mainly a result of the minimum wage increase of around 30% and the lagged effect of election pledges. As for private sector investment, with uncertainty over the Fed's and CBT's policies, the private sector again preferred to remain sidelined.
When we consider Turkey's medium- to long-term growth plan, in 1Q16 neither private investment, nor net external demand seem to satisfy initial conditions, as was the case for 2015. The anemic outlook on the investment front has been there since 2012.
For the coming period, parallel to our expectation, election campaign pledges clearly support domestic demand, and thus headline growth. However, depending on the extent to which election pledges are implemented, versus the extent of the drag of geopolitical tension on GDP, a GDP growth rate of 4% below the potential rate of 5% seems possible for 2016.



Another "message free" meeting….

O/N lending rate: 9% DOWN 50 BPS FROM 9.5%
O/N borrowing rate: 7.25% ON HOLD
1 week repo rate: 7.5% ON HOLD

Easing continues in June with 50 bps …

At its June meeting, the MPC cut the upper band to 9% from 9.5%, while keeping the other interest rates constant at 7.50% and 7.25%, respectively. The move was in line with market expectations. With June's move, the total cut in the upper band reached 175bps from 10.75% to 9%, while keeping other rates constant.

In the details, statements regarding the macro outlook were more or less the same as in May. There are some small differences; -concerns regarding core inflation were softened, while services inflation and increased unit labor costs necessitate the maintenance of a tight liquidity stance. Accordingly, there is a balanced view on the inflation outlook.

Comment:

The cut was in line with our forecast as we clearly see the determination in the Committee to cut the rates before the Fed begins to move. For the coming period, should the Fed not take any action we believe the MPC would continue its easing cycle.
As we have stated before, considering the relief due to the stability of economy management with the new government, the MPC's decisions will be a result of global winds. In other words, as long as global conditions permit, we expect the Bank to gradually continue easing monetary conditions. As such, we expect the Committee to continue with smaller steps i.e. 25 bps at its July/August meetings as long as global and domestic conditions remain supportive. Thus, keeping the current policy rate at 7.5%, we believe the Committee targets an upper band of 8.5%, before shifting to a single rate which will be in a range of 7.5% to 8%. Yet, we retain our reservation regarding whether that easing cycle would have a significant effect on credit conditions when we consider the geopolitical problems that hamper investment/consumption appetite.