

Annual inflation at its lowest since 1970...

The annual inflation declined to 4.9%, the lowest level since 1970...

At 0.4%, the monthly CPI inflation came in above the 0.3% market consensus in January. The high base of January 2010 due to a tax hike in tobacco products caused annual inflation to drop from 6.4% in December to 4.90% in January, which is the lowest since 1970.

Food group prices (1.6% MoM) contributed 0.4 points to monthly inflation, while clothing prices (-7.8% MoM due to seasonal factors) erased 0.6 points from the figure. Meanwhile, the closing output gap led the TRY weakness to affect inflation over transportation (1.4% MoM) and houseware prices (1.0% MoM).

H and I indices, the core inflation indicators, closely observed by the CBRT, showed monthly declines of 0.1% and 0.4% respectively. However, the annual H index inflation rose to 3.7% from 3.5%, while the annual I index inflation, the CBRT's most favored core inflation indicator, which excludes food, energy, tobacco and gold products, increased from 3.0% to 3.2%.

Core inflation started to rise...

On the production side, prices rose 2.6% MoM (10.8% YoY) in January on the back of the 2.3% MoM rise in industrial prices, and 2.9% MoM increase in agricultural prices.

The increasing cost pressure from producer prices should be reflected on consumer prices in the upcoming period. We forecast that in Q1, annual inflation may temporarily decline to near 4% on the back of base effects, before rising steadily to end-2011 near 7%, above the 5.5% official target, due to exchange rate pass-through to inflation as well as rising oil and commodity prices.

The Monetary Policy Committee seems to pause in its new monetary policy combination...

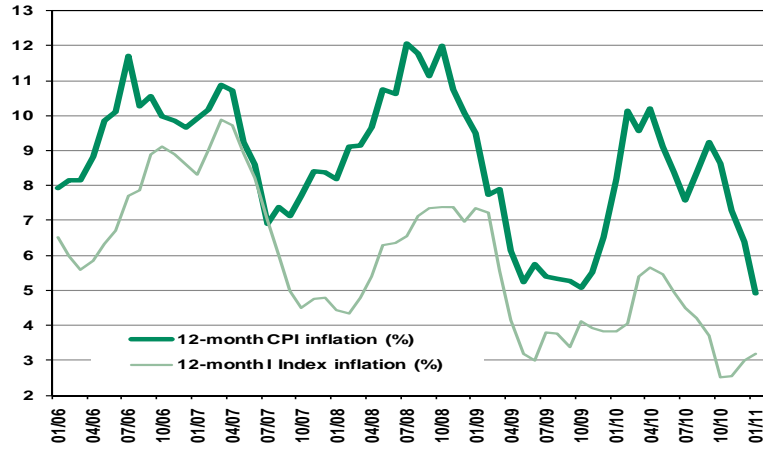
As for the monetary policy, the Monetary Policy Committee (MPC) kept the policy rate (one-week repo rate) unchanged at 6.25% in line with the market consensus and our in-house forecast. Meanwhile, the bank also kept O/N borrowing and lending rates at 1.50% and 9.0%, respectively. However, as important as unchanging the policy rate, the committee signaled that it will wait and see the effects of the measures it has taken until the next meeting. We read this statement as the bank is not likely to increase the reserve requirement ratios until the next meeting.

We forecast that the CBRT will be forced to increase the policy rate in the last quarter by 100 bps to 7.25%. According to our forecasts, the CPI inflation will likely end the year above the 5.5% official target and 5.9% inflation forecast, on the back of exchange rate pass-through to inflation, higher energy/commodity prices and a rapidly closing output gap as December IP figures attest.

Summary Inflation Data: January 2011
(in percent)

	Monthly		12-month	
	Jan 11	Jan 10	Jan 11	Dec 10
CPI	0.41	1.85	4.90	6.40
Food and Beverages	1.61	1.58	7.06	7.02
Tobacco and Liquor	0.00	22.04	2.15	24.66
Clothing and Footwear	-7.76	-8.20	5.24	4.74
Housing	0.58	1.51	4.93	5.91
o/w: Rent	0.37	0.40	3.94	3.96
Houseware	1.02	0.71	3.59	3.27
Health	0.28	-0.11	0.97	0.57
Transportation	1.44	3.53	4.63	6.78
Communication	1.21	-0.24	-1.81	-3.22
Entertainment and Culture	-0.08	-0.27	-2.13	-2.32
Education	0.04	0.07	4.22	4.25
Hotels, Cafes and Restaurants	0.76	1.11	9.38	9.76
Misc. goods and services	1.37	0.23	6.71	5.51
PPI	2.36	0.58	10.80	8.87
Agriculture	2.92	2.54	14.95	14.52
Mining and Quarrying	4.02	1.26	10.03	7.11
Manufacturing Industry	2.35	0.22	8.89	6.62
Electricity, Gas and Water	0.72	-0.62	20.28	18.68

Source: TURKSTAT



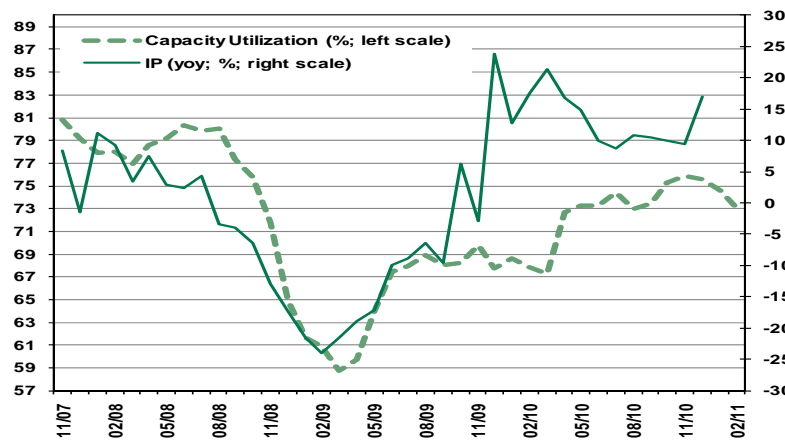
Source: Turkstat

Industrial production surges in December...

Working day and seasonally adjusted IP displayed an eye-catching 5.7% MoM rise in December...

At 16.9%, industrial production (IP) grew above the 12.1% market consensus and our forecast at 10.8%. The IP level in December brought a new record production level after October. Meanwhile, working day and seasonally adjusted series surged 5.7% MoM in December after a 1.0% decline in November.

With these results, IP expanded 12.1% YoY in the last quarter of 2010, which should translate into around 6.5% growth, bringing 2010 growth to 8.3% after 4.7% output contraction in 2009.



Source: CBRT, Turkstat

Capacity utilization is below the consensus in February...

Capacity utilization declined in February...

Capacity utilization for February came in at 73.0%, below the market consensus (74.2%) and below our in-house forecast (74.5%). While the capacity utilization rate (CUR) improved by 5.2 percentage points over February 2010, seasonally adjusted CUR declined 1.0 point MoM to 76.1%.

Further improvement in the labor market in November...

Unemployment rate declined in November, contrary to the seasonal trends...

Contrary to the seasonal trends, the unemployment rate declined to 11.0% in November from October's 11.2%. Meanwhile, the unemployment rate improved 2.1 points YoY in November, more than the year-on-year decline in October. On the other hand, the non-farm unemployment rate fell 2.5 points from November 2009 to 13.7%, while labor-force participation rate increased a mere 0.5 points to 48.6%.

In fact, seasonally adjusted figures released by TurkStat verified the progress in the unemployment rate. The SA unemployment rate continued its fall in the third consecutive month. It declined to 11.2% (the lowest level since September 2008) from 11.5% in October.

Current account deficit at a new record...

The record current account deficit increases concerns towards external financing...

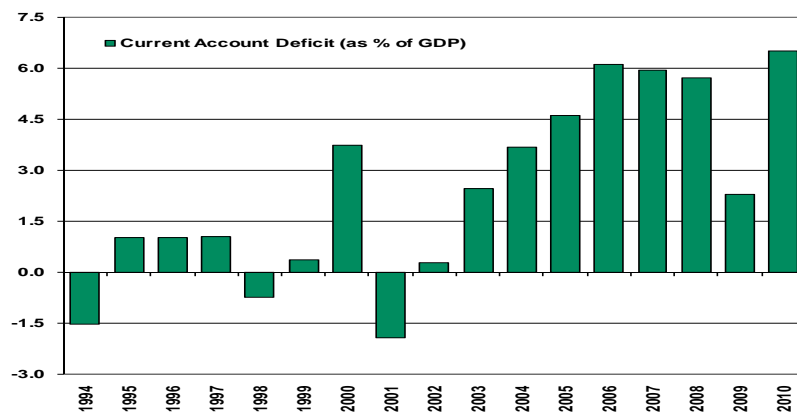
The current account balance posted a record monthly deficit of USD 7.5bn in December, higher than the market consensus (USD 6.8bn) and our more pessimistic forecast (USD 7.0bn). The result compares unfavorably with the USD 3.3bn CAD in December 2009. On the other hand, the total deficit was a record USD 48.6bn (6.5% of GDP) in 2010 compared to USD 14.0bn in 2009 (2.3% of GDP).

While there was USD 9.1bn inflow on the financing side, the CBRT accumulated reserves of USD 1.4bn in December. On the other hand, while Turkey attracted USD 1.5bn of FDI in December (high in "new normal"), there was a portfolio outflow of USD 0.2bn. The bulk of the CAD was financed by deposit inflows from foreign investors (USD 2.1bn) and withdrawals of bank deposits from abroad (USD 2.2bn) in the last month of the year. The support from medium to long term borrowing was absent as the banks and non-bank sectors paid net debt in December.

In 2010, record current account deficit was mainly financed by short-term inflows...

In 2010, the financing picture was parallel to that of December. While the share of net FDI in financing the CAD was low at 15%, short-term inflows won the race. Portfolio inflows (40%), withdrawal of bank deposits from abroad (22%), foreign investor deposits (29%) were the main financing items in 2010.

We forecast that the CAD will be close to USD 60bn (7.7% of GDP) this year, with a USD 100 per barrel oil price assumption, if the CBRT's new policy mix will prove unsuccessful. Brent oil prices currently over USD 100 mark would make the CBRT's mission more challenging, given its inflationary impact.



Source: CBRT, Seker Securities

Strong central government budget in January, as we expected...

The Central government budget registered a TRY 1.0bn surplus and a TRY 4.8bn primary surplus in January, thanks to lower interest payments and the strong performance of tax revenues compared to January 2010. The positive performance of the central government budget was in line with our expectation after the release of the January Treasury cash budget.

Positive January budget outcome decreased the concerns after the high budget deficit in December...

While the central government revenues rose 20% YoY to TRY 23.5bn, tax revenues increased 14.2% (more than the 10.3% envisaged for 2011 budget) to TRY 19.8bn in January. The bulk of the improvement seen in tax revenues comes from TRY the 1.4bn (19% YoY) rise in VAT and special consumption tax, reflecting the positive effect of strong economic momentum.

On the other hand, expenditures declined by 0.7% YoY to TRY 22.5bn with help from the decline in interest expenditures to TRY 3.8bn (January 2010: TRY 6.1bn). However, primary expenditures, which exclude interest expenditures, rose by 12.9% YoY to TRY 18.7bn in January.

While we find the central government figures positive, it should be noted that they partially reflect the shift in government expenditures to December in order to remain within budget targets this year.