

Below-expectation CPI reduces YoY inflation to 8.9%...

Sep14 CPI: +0.14% MoM (market expectations: 0.45%, Seker Invest forecast: +0.4%)

Sep14 DPI: +0.85% MoM

With the print, annual CPI declined to 8.9% from 9.5% recorded in August. Annual DPI inflation slightly declined to 9.84% from 9.88%.

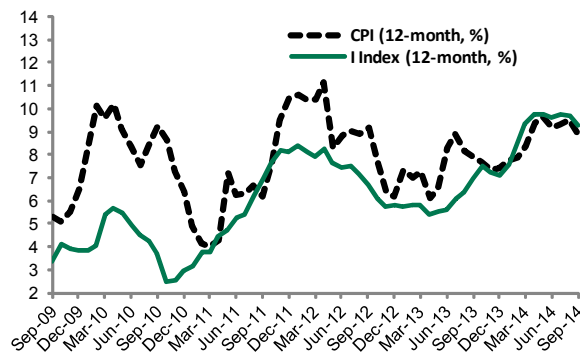
CPI increased below expectations at 0.14% MoM in September...

Regarding the details of the CPI print; in September, the softening of food prices with a 0.31% MoM rise emerged as the main reason behind the lower than expected MoM rise in headline CPI. However, despite the softer than September historical average MoM increase in food prices, annual food inflation is at around 14% (YtD 9.6%), significantly above headline inflation.

On the other hand, housing&rent together with hotels&restaurants were the main contributors to headline CPI at 8 bps. As might be recalled, in August, the MoM rise in the hotels&restaurants sub-item, at 1.64%, was remarkably higher than the average rise observed in August months, which may be attributable to the lagged effects of FX pass-through.

As for the core indices closely monitored by the CBT, core H and core I posted 0.38% and 0.28% MoM increases in September. Although we observe some decline in annual inflation figures; core H annual inflation is 10% and core I is 9.3%, doubling the CBT's medium-term inflation target of 5% and far off the 2014 YE inflation forecast of 7.6%.

CPI and Core Inflation (12-month, %)



Source: TURKSTAT

Comment;

As of September, YtD CPI reached 6.4% and YoY inflation was realized at 8.9%. Yet although there is a decline in annual inflation from August's print of 9.5%, it is still not a promising performance when we consider the CBT's 2014 YE inflation forecast of 7.6% and the target of 5%.

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

As of October, the government increased energy prices by 9%, implying 50 basis points extra pressure on headline CPI. For 2014, we keep our YE inflation forecast at 8.8%, as it had already included energy price adjustments.

IP fluctuation continues...

Turkstat has released the Aug14 IP print, wherein the IP index posted 12.6% YoY growth, marking its YtD strongest performance. The market expectation and Seker Invest forecast had been at 9.6% and 7% YoY growth, respectively.

IP in August increased above expectations...

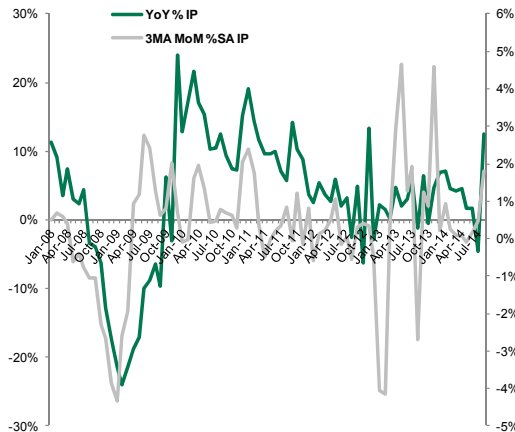
When we consider the strong base-year effect, as the index had posted its first YoY contraction in Aug13, reflecting the stress on the economy as of May13, we believe that seasonality and calendar-effect adjusted (SCE) IP yields a healthier picture. As such, SCE posted 1.4% MoM contraction in August, marking the YtD weakest performance.

In the details, we see a wholly different picture in terms of contributors when compared to July as that month's worst performers became the main contributors to the headline print in August. Accordingly, "manufacture of food products" was the key contributor to the headline print on 17% YoY growth (1.8 pps contribution) followed by the "manufacture of autos" sub-item on 17% YoY growth (1.7 pps contribution). The third contributor was "textiles" on 11% YoY growth (1.3 pps contribution).

Comment

After July's 4.6% YoY contraction, IP posted 12.6% YoY growth in August mainly underpinned by the base-year effect as SCE posted its YtD weakest performance in August. 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. Accordingly, even with the August boost, in May-Aug14 IP could perform only slightly better on YoY terms (average: 2.8%) compared to the May-Aug13 period (average: 2.4%).

For the coming period, with the halting of the easing cycle on MPC side and increasing rates, together with both anemic domestic and external demand, we do not foresee a remarkable recovery in IP and expect 2H14 to be a challenging environment, especially for emerging economies like Turkey. Accordingly, we keep our 2014YE GDP growth forecast at 3%, vs. the government's revised GDP growth forecast of 3.3%.



CA deficit slightly inched up to USD48.9bn...

Rebalancing loses steam...

Aug14 CAD: USD2.8bn (Aug13 CAD: USD2.4bn)

YoY increase, registered below market expectations of USD3.2bn on stronger than expected tourism revenues. Seker Invest's forecast was for a USD3.5bn deficit. With this print, as we stated in our July note, contraction in 12mth rolling CAD has halted, and thus 12 mth rolling CAD edged up slightly to USD48.9bn from USD48.5bn.

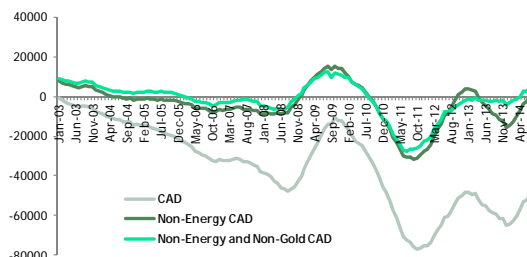
On the financing front; contrary to July's weak performance, in August, capital inflows of USD3.8bn were adequate to cover the headline CAD of USD2.8bn. In detail, portfolio inflow fluctuations continued.

Accordingly, in August, portfolio accounts turned red at USD1.8bn, versus July's inflow of USD3.4bn.

Comment:

In the first eight months of the year, the CAD deficit realized at USD29.6bn, down from the Jan-Aug13 cumulative figure of USD45.8bn on 35% YoY contraction. The improvement in CAD of around USD16.3bn stems mainly from contraction in the trade deficit. However, with August, we see some loss of steam in the rebalancing process with exports losing some momentum and imports gaining pace.

In the Medium Term Program, the government revised downward its CAD forecast from USD55.5bn (6.4% of GDP) to USD46bn (5.7% of GDP). Our CAD forecast stands at USD50bn, in other words 6.3% of GDP.



MPC held all interest rates constant for the second consecutive month...

No news, good news....

The MPC held all the interest rates constant at its October meeting parallel to the market consensus and Şeker Invest forecast for the second consecutive month. The statement was a carbon copy of September's note. As a reminder of the highlights;

-Due to the tight monetary stance and macroprudential measures, loan growth rates follow a moderate trend.

-Despite the slowdown in global demand, exports continue to support GDP growth.

-Positive impacts of the macroprudential measures taken at the beginning of the year and the tight monetary stance are 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. Differing from September's note, the time for support of headline inflation is defined as "next year".

Comment:

October's MPC meeting is just like "no news" for the market as it was a consensus call that the MPC would keep all rates on hold in light of challenges arising from global financial markets and still discouraging inflation outlook.

Furthermore, recently the CBT made certain moves such as increasing the export rediscount credits' limit and paying interest rates on TL required reserves. The first move is to strengthen FX reserves and the second is to make keeping RRs in TL attractive, an act to support the lira in the coming period. Additionally on Tuesday, the Bank announced that the use of a depo market facility for short term FX needs would be available only to those that used their available FX reserves kept via the Reserve Option Mechanism (ROM).

As may be recalled, ROM is a facility to permit banks to keep their TL RRs in FX by some coefficient. This is also expected to create extra demand for TL if used. All in all, we observe via halting the easing cycle and macroprudential tools the MPC is getting ready for the challenging period ahead, which will be shaped by the major global central banks, especially the FED.