

Benign food prices drag inflation down

Monthly CPI inflation for November came in at 0.38%, notably below the consensus (0.9%), but closer to our forecast of 0.6%. Hence, annual inflation declined to 6.37% from the 7.80% registered in October.

Continued decline in annual core inflation indicators in November...

Food group prices, declining just 0.1%, erased 3 bps from the monthly inflation figure, while clothing group prices (up 6.3% MoM) rising more than the seasonal average, made a 0.4 pp contribution to inflation. Hence, annual food inflation declined to 4.3%, notably below the CBRT's year-end assumption of 7%, from 7.9% in October. Meanwhile, transportation group prices declined by 1.0%, erasing 16bps from the monthly figure thanks to a decline in fuel prices and year-end discounts on automobile prices.

We expect year-end inflation at around 6.3%...

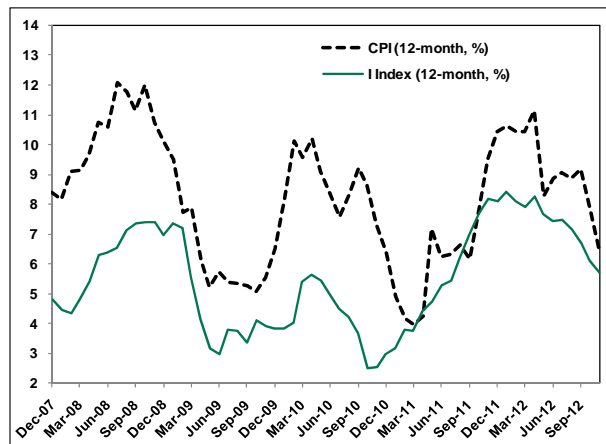
All annual core inflation indicators continued to decline in November. The CBRT's favorite annual core inflation indicator, I index inflation declined to 5.7% from 6.1% in October.

Inflation will likely end the year at around 6.3%, notably below the CBRT's October inflation forecast, but 2013 does not seem too promising. Our forecast for end-2013 is at 7.6%, notably above the CBRT's 5.3% forecast and 5% target. The previously-decided-on increase in the proportional tax rate on tobacco products to 69% from 65% in January 2013, the low base of food prices in Q4, and potential hikes in natural gas and electricity prices are next year's main risks to inflation. As the CBRT does not want the lira to lose its competitiveness, it is difficult to expect a meaningful support for disinflation from nominal lira appreciation next year.

**Summary Inflation Data: November 2012
(in percent)**

	Monthly		12-month	
	Nov 12	Nov 11	Nov 12	Oct 12
CPI	0.38	1.73	6.37	7.80
Food and Beverages	-0.12	3.27	4.32	7.87
Tobacco and Liquor	0.01	3.69	0.97	4.68
Clothing and Footwear	6.28	5.59	7.44	6.75
Housing	0.56	0.61	11.69	11.75
o/w: Rent	0.57	0.42	5.35	5.20
Houseware	0.21	1.15	5.97	6.97
Health	-0.05	0.23	1.56	1.83
Transportation	-0.97	-0.55	6.01	6.46
o/w: Maintenance	-1.68	-1.43	11.12	11.41
Communication	0.10	0.90	4.98	5.82
Entertainment and Culture	-0.32	0.01	2.97	3.31
Education	0.07	0.07	4.70	4.70
Hotels, Cafes and Restaurants	0.67	0.62	9.44	9.39
Miscellaneous goods and services	0.04	1.69	8.90	10.70
PPI	1.66	0.65	3.60	2.57
Agriculture	-2.96	5.40	-0.73	7.81
Industry	2.60	-0.25	4.49	1.59
o/w: Mining and Quarrying	0.57	0.18	5.97	5.56
Manufacturing Industry	-0.55	-0.50	1.64	1.68
Electricity, Gas and Water	30.12	1.86	27.34	-0.32

Source: TURKSTAT



Source: TurkStat

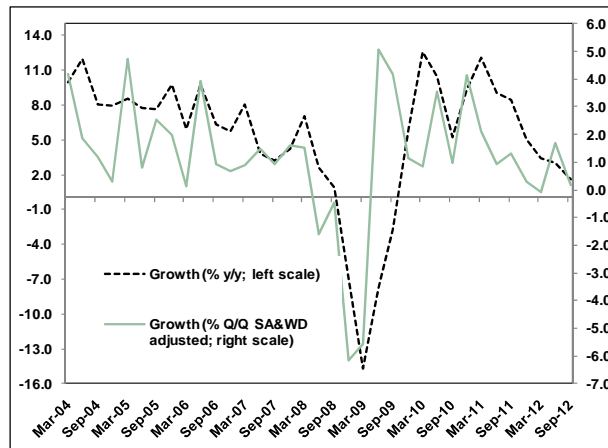
GDP growth weaker than expected in Q3

Gross domestic product grew by 1.6% YoY in Q3, thus less than expected by the market (2.6%) and our forecast (2.2%). Meanwhile, adjusted for seasonality and the working-day effect, economic activity rose by just 0.2% QoQ in Q3.

Net foreign demand remains the key driver of growth in Q3. While private consumption declined by 0.5% YoY, private investments fell by 11.1% following a 7.7% decline in Q2. Hence domestic demand deducted 1.7 pps from growth. On the other hand, falling imports (-2.4% YoY) and rising exports (11.9% YoY), caused a contribution of 3.4 percentage points. Meanwhile, stock changes made a 0.1 pp negative contribution.

Domestic demand remains weak in Q3...

GDP rose by 2.6% YoY in the first 3 quarters of the year and economic activity might have recovered in the last quarter, but only slightly according to our initial forecasts. Therefore, we forecast full-year growth at 2.5% before rising to 4.5% next year as the effects of the CBRT's accommodative monetary policy stance are fully felt in economic activity in Q1.



Source: Turkstat

Cumulative CAD continued its decline in October

At USD 2.0bn, the current account deficit registered broadly in-line with the market consensus and our in-house forecast (both at USD 2.1bn) in October. The high base of USD 4.5bn last year caused the 12-month rolling figure to decline to USD 53.1bn from USD 55.7bn registered in September. Meanwhile, cumulative non-energy CAD declined to USD 1.1bn from USD 3.4bn, continuing to narrow going into Q4.

October's current account deficit was broadly in-line with the consensus...

Financing was strong in October, but dominated by portfolio and deposit inflows. Including the USD 4.5bn reserve built-up by the CBRT, the Turkish economy attracted USD 5.8bn inflows in October. FDI was weak at USD 0.3bn, while the banking sector paid a net medium-to-long term debt of USD 0.4bn as it issued Eurobonds, while the corporate sector rolled over almost all of its debt. And while equities saw inflows of USD 0.4bn in October, and government debt securities attracted USD 1.4bn in October, banks and other sectors borrowed USD 2.3bn and USD 0.5bn respectively by issuing Eurobonds. Asset draw-down of local banks contributed USD 1.6bn to financing in October, while foreign banks increasing their deposits in Turkish banks by USD 1.9bn in October, were also important sources of inflows in October.

Portfolio inflows and deposits were dominant in October's financing picture...

October's data clearly shows continued rebalancing of economic activity as of that month, even when considering the effect of gold exports. We maintain our annual CAD forecast for this year at USD 53bn (6.6% of GDP) with risks tilted towards the downside. Meanwhile, we also maintain our forecast for next year of USD 61bn (6.8 % of GDP).

Current Account Developments
(in millions of US\$)

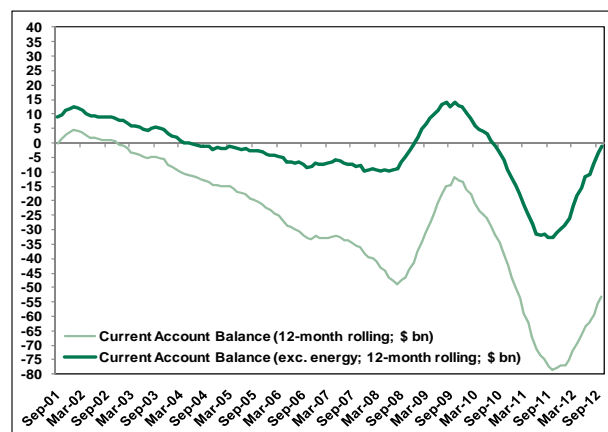
	Oct		12-month rolling	
	2012	2011	Oct	Sep
Current Account	-1,960	-4,501	-53,114	-55,655
o/w: Non-Energy 1/	2,140	-124	-1,117	-3,380
Trade Balance	-4,096	-6,388	-68,356	-70,648
Exports	14,127	12,803	159,241	157,917
%	10	11	159	160
Imports	-18,223	-19,191	-227,597	-228,565
%	-5	16	-12	9
Services (net)	2,624	2,302	20,525	20,203
o/w: Tourism (net)	2,128	2,221	18,236	18,329
%	-4	-2	34	37
Income (net)	-584	-472	-6,846	-6,734
o/w: Interest Expenditure	-481	-427	-5,680	-5,626
Current Transfers	96	57	1,563	1,524
Memorandum Items: 2/				
Trade Balance	-5,511	-8,012	-85,192	-87,694
Energy 3/	-4,100	-4,377	-51,997	-52,275
Non-Energy	-1,411	-3,635	-33,195	-35,419

1/ Current account less energy deficit by TURKSTAT definition, i.e. energy imports including cost-insurance-freight.

2/ TURKSTAT definitions.

3/ STIC definition; including crude oil, petroleum products and natural gas.

Source: CBRT



Source: CBRT

CUR finally revives, but still insufficient

Capacity utilization fell by 1.9 pp over a year ago to 73.6% in December (November: 74.0%). However, seasonally-adjusted capacity utilization improved by 1.6 pp over November to 74.5% in December, following a 0.4 pp MoM decline in November. The current level is the highest recorded since May of this year.

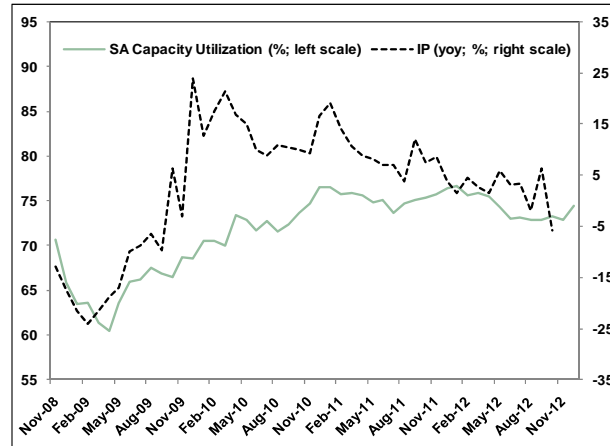
Capacity utilization rate improved in seasonally-adjusted terms in December...

The improvement in SA capacity utilization stems from that of capital goods and intermediate goods manufacturing, and spells good news for the pace of economic activity in the upcoming period. By our calculations, capacity utilization for capital goods rose by 4.3 pp over November to 74% in December. Meanwhile, capacity utilization for durable consumer goods manufacturing declined by 0.2 pp over November. On the other hand, non-durable consumer goods capacity utilization remained flat on the previous month.

Elsewhere, the other data release of the day has not provided positive signals for the pace of economic activity. At 97.9, the real sector confidence index declined below the 100-mark (separating expansionary and contractionary tendencies in the manufacturing sector) for the first time this year. The decline in the seasonally-adjusted confidence index also confirms the case. The SA index fell to 107.7 from the 108.7 recorded in November. From this perspective, the deterioration is broad-based in the sub-indices excepting those for total orders (last 3-months) and fixed investment expenditures, which rose 1.3% and 0.5% MoM, respectively.

CUR data points to just a slight recovery in Q4...

In Q4, the average SA capacity utilization rate rose 0.5 pp over Q3 to 73.5%, which is among indicators suggesting that economic activity may have revived just slightly in the final quarter of the year.



Source: CBRT, TurkStat

Monetary policy’s focus on financial stability next year

CBRT Governor Erdem Basci has outlined Monetary and Exchange Rate Policy to be followed in 2013 at a press conference. The 2015 inflation target is set at 5% accordingly. In addition, the 2013 uncertainty band is maintained at 3%-7%. The CBRT expects inflation to end the year below the lowest level since it started inflation targeting, i.e. 6.4% recorded in 2010. The Bank expects an inflation level very close to the 5% target by year-end.

CBRT to continue with multiple objectives and multiple instruments in 2013...

Price stability remains the primary objective of the CBRT. The secondary objective is financial stability as it supports the price stability objective with lower exchange rate and credit growth volatility, according to the Governor.

The CBRT will continue its unorthodox monetary policy with multiple objectives and multiple instruments in 2013. The Bank has the following instruments at its disposal: Policy rate, Interest Rate Corridor, TRY&FX liquidity management tools, Reserve Requirement Ratios, Reserve Option Mechanism, Instruments of the lender of last resort, and Reserve Requirement Ratios based on leverage ratios. The first 5 will be used in 2013, while leverage-based RRRs will be used in 2014 as 2013 will be a reporting period. The CBRT will not have recourse to FX buying and selling auctions in 2013. As an automatic stabilizer, ROM will prevent lira volatility in 2013. In addition, the main tool with which to accumulate reserves will be export rediscounting credits. As for reserve accumulation, the effect of ROM changes will be less than that of rediscounting credits.

Currency fluctuates within the ranges the CBRT is comfortable with according to Erdem Basci, and volatility will be low next year. In 2013, REER will be followed closely by the CBRT in order to protect financial stability, while the CBRT has no target for the real or nominal exchange rate, according to the Governor. In Basci’s words, the CBRT will not be indifferent to excessive lira appreciation or depreciation in the upcoming period.