July Inflation

YoY CPI inflation declined to 11.8% from 12.6% in July.

TURKSTAT has revealed July CPI inflation at 0.58%, below the 0.85% median market expectation. YoY CPI inflation declined to 11.8% from 12.6%. Core CPI inflation (group C) was 0.8% MoM, declining to 10.3% from 11.6% on a YoY basis. D-PPI inflation was 1.02%, which brought YoY D-PPI inflation to 8.3% from 6.2%.

Food inflation printed a 1.3% decline MoM, while the furthest declining group among the main expenditure groups was clothing and footwear, with a 3.5% decrease MoM. While the transportation group saw the highest increase in July with a MoM rise of 2.44%, the goods and services group rose by 2.39% MoM, and the household goods group by 2.38% MoM.

In addition, we mention that in the third inflation report of the year, the CBRT revised the 2020 CPI inflation forecast from 7.4% to 8.9%, while revising the forecast for 2021 from 5.4% to 6.2%.

July MPC Decision

The CBRT has kept the policy rate (one-week repo auction rate) constant at 8.25%, in line with the market expectation.

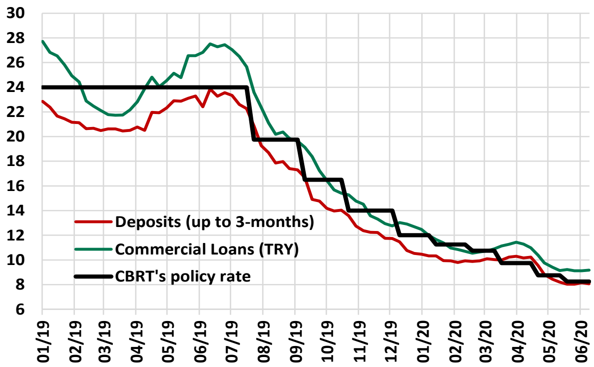
The CBRT identified the potential risk factors for inflation as being increased core inflation indicators…

The CBRT identified the potential risk factors for inflation as being increased core inflation indicators (due to a pandemic related rise in unit costs), supply side factors (due to pandemic related restrictions), and food prices (due to seasonal and pandemic related effects). It also maintained the view that demand-driven disinflationary effects would become more prevalent in the second half of the year, but that risks to the year-end projection were considered to be on the upside due to recent inflation realizations. The sustainability of the disinflation process, decline in long-term interest rates, recovery in the economy, and decline in the country's risk premium will remain significant considerations, according to the Bank.

The fact that the CBRT states that financial markets and economic activities support the production potential of the economy through monetary and fiscal measures implies growth. Nevertheless, the CBRT also stated that despite the drop in tourism revenues due to the pandemic, a partial improvement is expected by easing the travel restrictions. The CBRT continued its non-optimistic attitude towards aggregate demand conditions.

The CBRT has resumed a more cautious approach at its last two meetings, and we think that the Central Bank may recess its rate cutting cycle until inflation figures improve, as current data avails no further room for rate cuts.

Graph 1: Policy rate vs. deposit and loan rates (%



Source: CBRT, SEKER Invest

May industrial production & sector turnover indices

Contraction in IP moderates in May compared to April, but still remains significant…

The industrial production index registered a whopping 30.6% YoY deceleration in May, following the 31.4% YoY deceleration of April. Yet, the May result is partially attributable to fewer working days due to the Bayram holiday (it was in June last year), whereby the WD adjusted IP index points to a milder 19.9% YoY

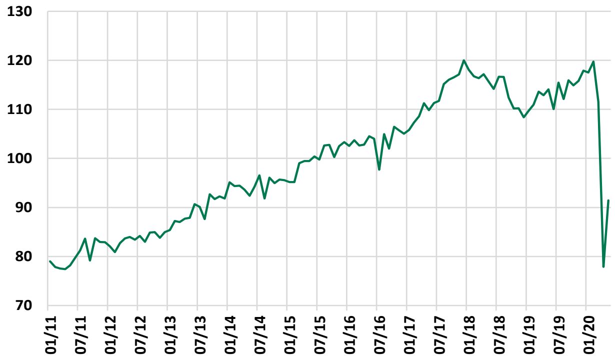
deceleration. The WD and seasonally adjusted IP series also point to a 17.4% MoM improvement after April's 30.2% MoM contraction.

Although the sequential recovery in May is significant, the current index level is still 18% below the March level, and about 24% below that of February. Normalization measures and early indicators imply that the sequential recovery has continued at a considerable pace in June, although returning to pre-pandemic levels will most likely be possible by late 2020/early 2021.

Most of the subsectors faced a severe YoY contraction…

Most of the subsectors seem to have registered a severe YoY contraction, which is actually not surprising, with the wearing apparel, motor vehicles, furniture, textile, and electrical equipment sectors affected the most, as already signaled by the capacity utilization rates disclosed earlier. We see that the YoY contraction in these sectors are a respective 46%, 37%, 33%, 32%, and 24%. On the other hand, the paper sector was the only one to register YoY growth of some 4%, and pharmaceutical sector production fell by a mere 0.4% YoY. Note that all these figures are in WD adjusted terms.

Graph 2: Industrial production index; seasonally and WD adjusted



Source: TURKSTAT

Aside from IP data, TURKSTAT has also disclosed sectoral turnover and volume indices today, which display similar results to those of IP:

*The **retail sector volume index** for May also pointed to a 16.7% YoY deceleration in WD adjusted terms and 20.9% in unadjusted terms. Yet, the headline figure was actually limited by food spending, which increased by 3.0% YoY, while non-food spending has actually fallen by 25.5% (in WD adjusted terms).*

*Skipping the nominal changes in the turnover indices and focusing on real changes, we calculate that the **wholesale and retail trade turnover index** fell by some 16% in real terms, and the **services (ex-trade) turnover index** saw 33% YoY deceleration, as we note that shrinkage in revenues for hotels-restaurants and air transportation of over 70% was partially compensated for by the information & communications sector, where revenues rose by 2% YoY in real terms. The **construction turnover index** also points to some 16% YoY deceleration in May.*

Today's results confirm double-digit contraction concerns for 2Q GDP

IP and other sectoral turnover/volume indices for May actually point to similar results already suggested by capacity utilization, electricity consumption and manufacturing PMI, etc. Accordingly, we believe that it is certain (and unsurprising) that the economy has bottomed out in April, that and sequential improvement has started from May (and become more pronounced in June and early July as indicated by other indicators). Accordingly, we are likely to witness a positive reading for YoY IP growth in June in unadjusted terms. That said, the sequential recovery is partially attributable to inventory pile-up and pent-up demand after two months of lockdown. We would still expect the sequential recovery to continue over the coming months, although the pace of recovery may somewhat dwindle overtime.

On the other hand, easing lending rates have also boosted consumer loans recently, especially for housing and automotive segments, which would mitigate the initial downtrend in economic activity, and ultimately limit the pace of a potential GDP contraction in 2020.

May balance of payments

C/A balance turns into deeper deficit in May…

In May, Turkey printed a USD3.8bn C/A deficit (USD1.1bn surplus in the same month of 2019), slightly below the USD4.0bn median market expectation. This brought the 12-month rolling C/A deficit to USD8.2bn from USD3.4bn last month.

There has been a USD7.3 inflow from the capital account, including the USD10bn swap account with the Qatar Central Bank, and together with the USD0.8bn outflow through the "net errors" item, official reserves increased by USD2.7bn, after falling by about USD25bn in the prior two months.

For the January-May period, the C/A deficit reached USD16.7bn, vs. USD0.1bn surplus in the same period of last year, while there was a USD1.5bn capital outflow, vs. a USD0.3bn inflow last year. With the USD4.1bn outflow classified as "net errors", the y-t-d deceleration in official reserves amounts to USD22.4bn.

Although the swap agreement with the Qatar Central Bank worth USD10bn in May made a significant contribution to the capital account, we see total capital inflows of USD7.3bn, which implies that capital outflows have actually lingered into May, when the mentioned swap agreement is excluded.

April employment data

TURKSTAT announced that the seasonally adjusted unemployment rate rose MoM to 13.8% in the April (March-May) period from the prior period's 13.1%. Non-employment unemployment rate and youth unemployment rate rose to 16.1% and 26.6% from respective figures of 15.2% and 25.1%.Meanwhile, the unadjusted rate stood at 12.8%, down from 13.0% in the same period of last year.

Decline in workforce participation continues to limit the deterioration in the unemployment rate…

Yet, as was the case in recent months, the dramatic decline in workforce participation is the factor limiting the deterioration in the unemployment rate. Analyzing from the seasonally adjusted series, we see that a further 893K worker has been dropped out of the workforce over the past (rolling) one month period, in addition to the 2.0 million already quitted between November and March. Employment fell by 968K MoM bringing the cumulative employment loss to 2.7 million since March. Yet, the deceleration in the workforce limited the number of people defined as unemployed, and there was only a 76K increase. As a result, unemployment rate actually rose to a limited extent considering the extent of the employment loss in recent months. Yet, this has been achieved with a much lower workforce participation rate of 47.5%, which has come down from about 53% from late 2019.