March Inflation …

Annual inflation rose to 11.3%

March inflation came in at 1.0% MoM, thus above market estimate of 0.6% MoM and our estimate of 0.75%. Annual inflation rose to 11.3% YoY from 10.1% YoY in February. We believe that the reason behind the higher inflation realization was higher food inflation than expected.

Core inflation-I was at 1.25% MoM in line with our expectation of 1.15%. Accordingly, annual core inflation rose to 9.5% from 8.6% in February. Higher core inflation was driven core goods and transportation and other services. Services inflation excluding transportation&other services was subdued, in fact seasonally-adjusted terms was in negative territory, pointing to moderate demand conditions. Core goods inflation (primarily due to lagged effects of fx pass thru) was high across the board, with about 2% higher clothing&durable goods.

Producer price inflation decelerated somewhat to 1.0% MoM from 1.3% MoM in February, bringing 6-m cumulative inflation to 12.1 ppts (long-term average 3.5ppts). This amounts to the highest cost inflation since 2008 (13.9 ppts)

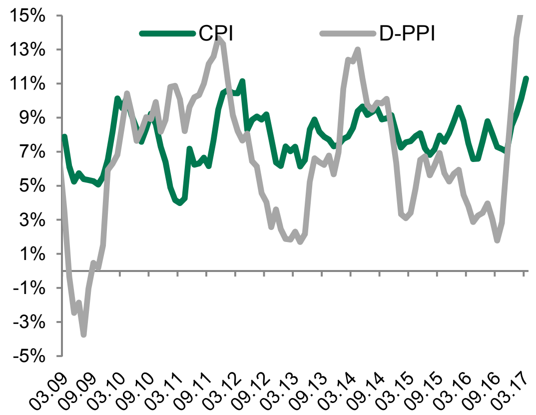
We believe dealers/retailers are still absorbing the rise in costs. Going forward, we expect to see more fx-pass-thru on core goods. In addition, services inflation will also trend higher due to higher food&energy and lagged effects of higher core goods prices. The dealers/retailers will eventually reflect the rise in their cost base, which is still not fully reflected in the core good prices at the retail level. We expect core inflation to rise above double digits by 3Q17 and in fact core inflation could end the year near double digits.

Food prices rose by 2.0% MoM, somewhat above its seasonal average. However, due to unseasonably low print last year, food prices rose to 12.5% YoY from 8.7% YoY in February, led by high unprocessed food prices.

We revise our 2017-end inflation expectation to 10% from 9%.

Given the very low level of food prices last year and continuing pressure on food prices, annual food inflation could easily see near 15% in 4Q17.

Given the deterioration in the food inflation outlook, unabated producer price inflation and stimulative measures that are being implemented, we revise our 2017-end inflation expectation by a full ppt point to 10% from 9%.



Feb CAD in line with the expectations.

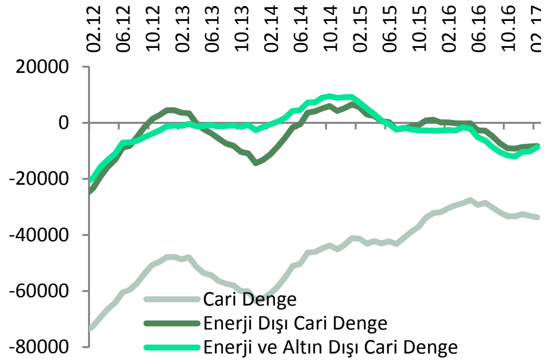
12mth rolling deficit at USD33.8 bn…

CA deficit came in USD2.5bn in February The 12mth rolling deficit rose to USD33.8 (3.9% GDP), thus above the USD33.2bn of January. The 12-mth rolling CA balance excluding energy & gold & unprocessed industrial materials was unchanged at USD3.3bn as compared to January.

Deterioration in the aforementioned balance which began in 2015 (cyclical high of USD14bn), due to the loss of tourism revenues, has continued to improve for a third consecutive month. Tourism revenues, the weakest link in the CA balance dynamics since 2016, showed further sign of stabilization with a 12.5% YoY decline vs. an average 25% YoY decline in 2016.

In February FDI was USD0.6bn while government bond inflow was USD200mn and equity inflow was USD300mn.

All of this resulted in USD600mn official reserve accumulation following USD9bn reserve loss in December 2016-January 2017.



Inflation Report II - 2017…

YE17 inflation estimate revised to 8.5% from 8.0% due to rise in import price assumptions and narrower output gap estimate

2018-end inflation was also revised to 6.4% from 6.0% on the basis of narrower output gap and higher inflation inertia estimate. Inflation still seen reaching 5% target in YE19.

Main Headlines

Loan growth is stronger than in previous years owing to macro prudential policies supportive of the financial system.

YE17 inflation estimate revised to 8.5% from 8.0%.

The first quarter of 2017 was marked by steeper cost pressures on producer prices and by an increase in core inflation indicators.The relative recovery in demand conditions and the high inflation expectations led to price hikes.

After the temporary third-quarter slowdown, economic activity recorded a moderate growth driven by domestic demand in the fourth quarter of 2016.The upsurge in exports of goods, as well as accommodative incentives and measures are likely to help economic recovery strengthen from the second quarter onwards.

The first-quarter data for 2017 hints at diminishing recovery in economic activity in the first quarter. Following a robust increase in January, industrial production contracted in February. Rapid depreciation of the Turkish lira at the start of the quarter, uncertainties led by volatile financial markets and the leap in inflation are projected to dampen consumption and investment spending.

Central bank surprised this time….

The CBRT MPC has raised the O/N late liquidity rate to 12.25% from 11.75%, thus surprising the markets, which had a consensus expectation of no change (other rates were unchanged as expected). We deem the decision positive, boosting the inflation-fighting credentials of the CBRT as medium-term inflation expectations have further de-anchored.

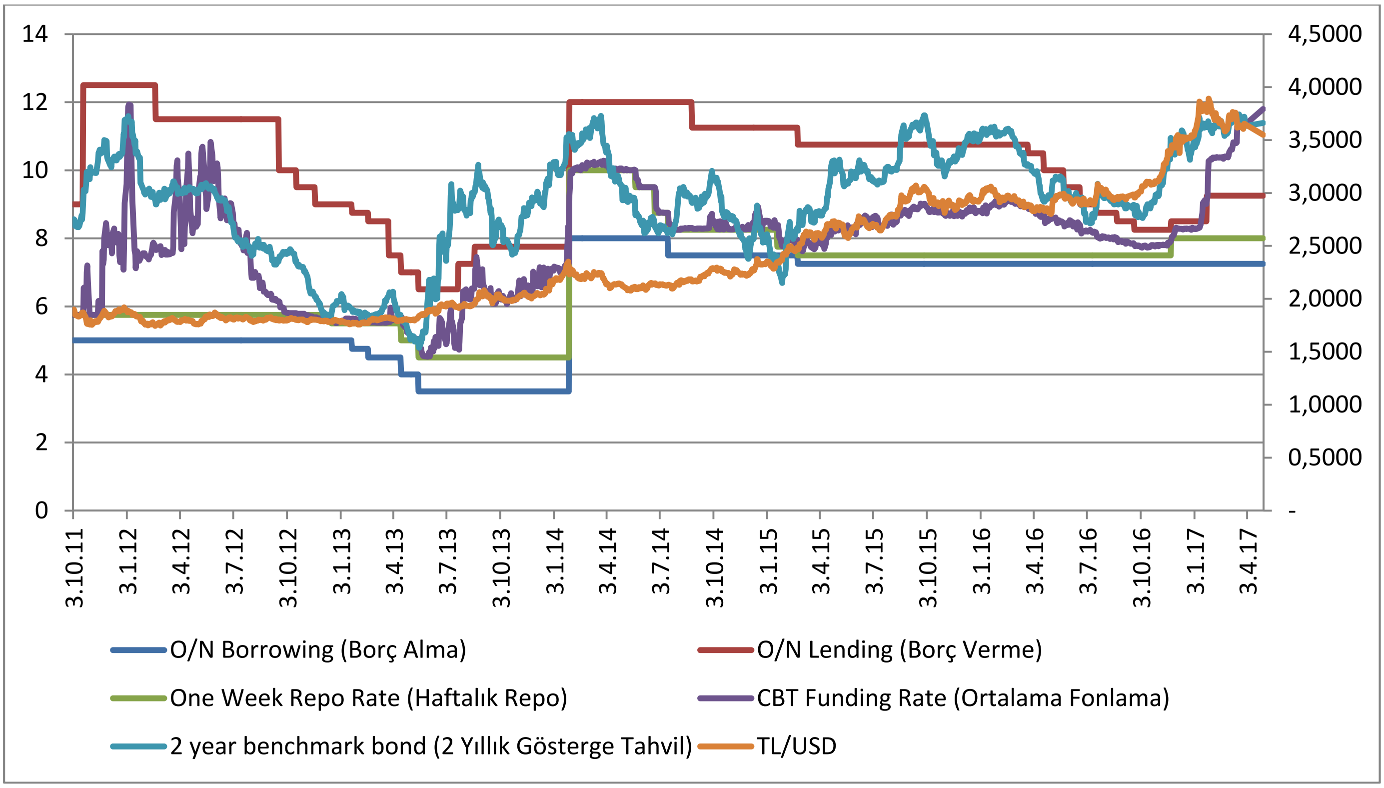
The MPC has raised the late liquidity window by 50 bps to 12.25%.

The rebound in economic activity seems to have lowered the bar for the Bank to raise rates. However, we believe, the most important factor was the deteriorating inflation outlook.

Core inflation may surprise on the upside going forward given a probably narrower than expected output gap and lags in cost-driven inflation.

In the accompanying note the phrase “a significant rise in inflation is expected to continue in the short term due to lagged pass-through and the base effect in food prices” was replaced with “although recent improvement in risk appetite contains some of the upside pressures from cost factors, currently elevated levels of inflation pose risk to pricing behavior”.

The elimination of lagged pass-through and the base effect in food prices was surprising, as the aforementioned risks are ongoing. Instead, the Bank seemed to be more concerned with the effects on pricing behavior.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O/N Borrowing (Borç Alma)
O/N Lending (Borç Verme)
One Week Repo Rate (Haftalık Repo)
CBT Funding Rate (Ortalama Fonlama)
2 year benchmark bond (2 Yıllık Gösterge Tahvil)
TL/USD