

# VAKIFBANK TURKISH ECONOMY WEEKLY

**How will Turkish Economy Perform  
in 2011?**

**No2: Inflation and Monetary Policy**

  
**VakifBank**

T. Vakıflar Bankası T.A.O



**After analyzing economic growth last week, we are examining 2011 inflation and monetary policy in this week's report .**

## **Last Week**

**Real GDP Growth Rate**

## **This Week**

 **Inflation and Monetary Policy**

## **Next Weeks**

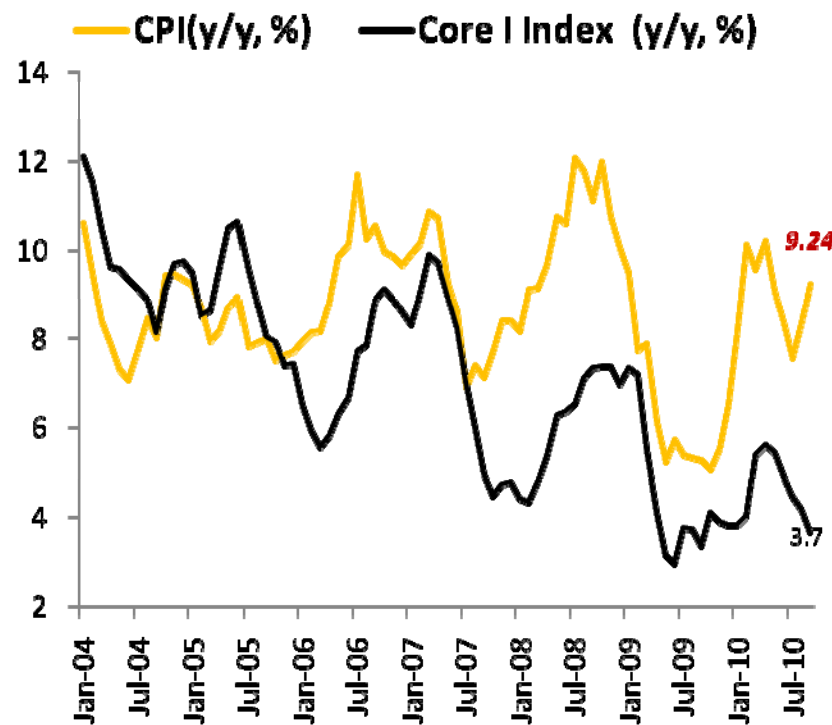
**Current Account Balance**

**Unemployment Rate**

**Financial Markets: Interest Rate and Currency**

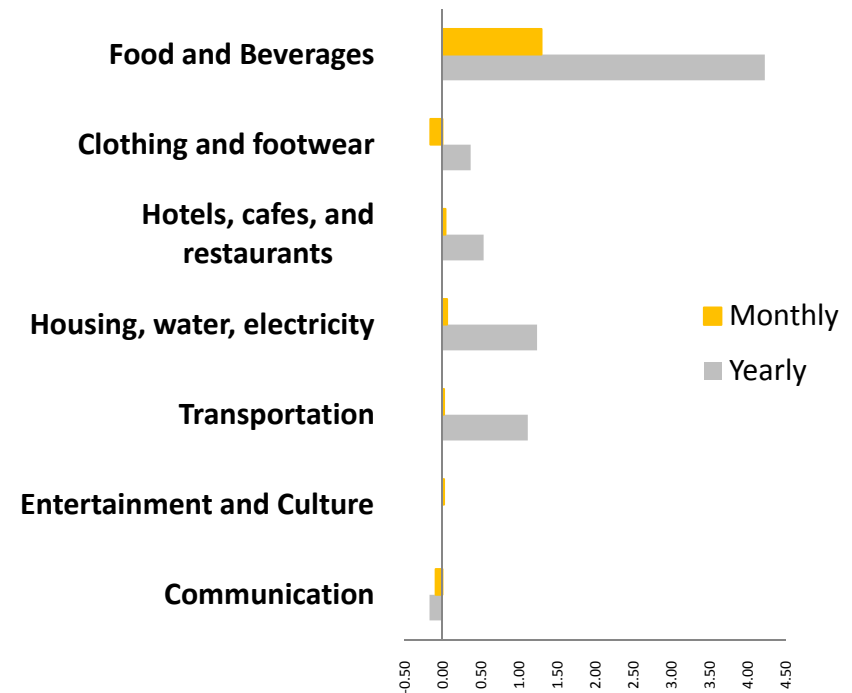
# Headline CPI rose by 1.23% mom in September more than 0.8% mom market consensus and our 0.9% mom forecast...

Based on upside surprise in food prices (4.7%mom), annual CPI inflation increased to 9.2%yoy from 8.3%yoy. For the coming months, food prices especially unprocessed food prices are expected to rise due to unfavourable seasonal effect. However, core inflation pressures remain weak.



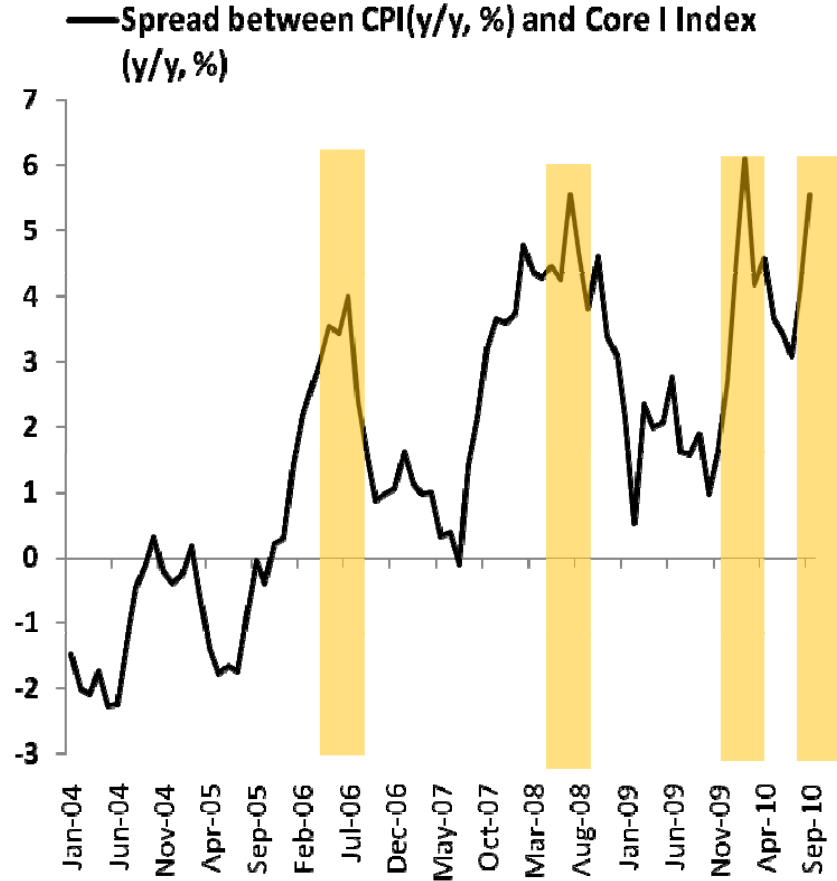
Sources: CBRT

## Contributions to CPI



Sources: TurkStat

## Core inflation has been decreasing since April...



Sources: Turkstat, Vakifbank



Spread between headline and core inflation widened sharply in September.



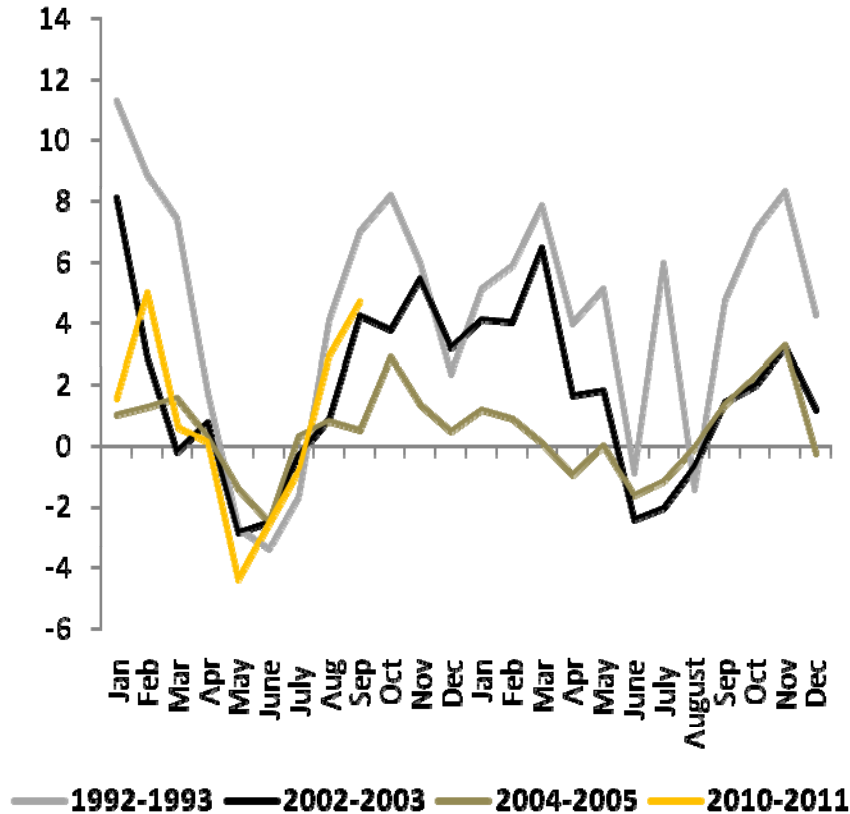
Our analysis shows that sticky headline inflation movements affect core inflation with a lag. Therefore, an increase in headline inflation may cause an increase in core inflation after October.






Although we expect the headline and core inflation to decrease year on year in October, spread between the headline and core inflation will get narrower since a decrease in the headline will be more drastic than a decrease in the core.

## Food prices in 1992-2002 and 2004 had a very similar trend to food prices in 2010...

Food and Non-Alcoholic Beverages (m/m,%)



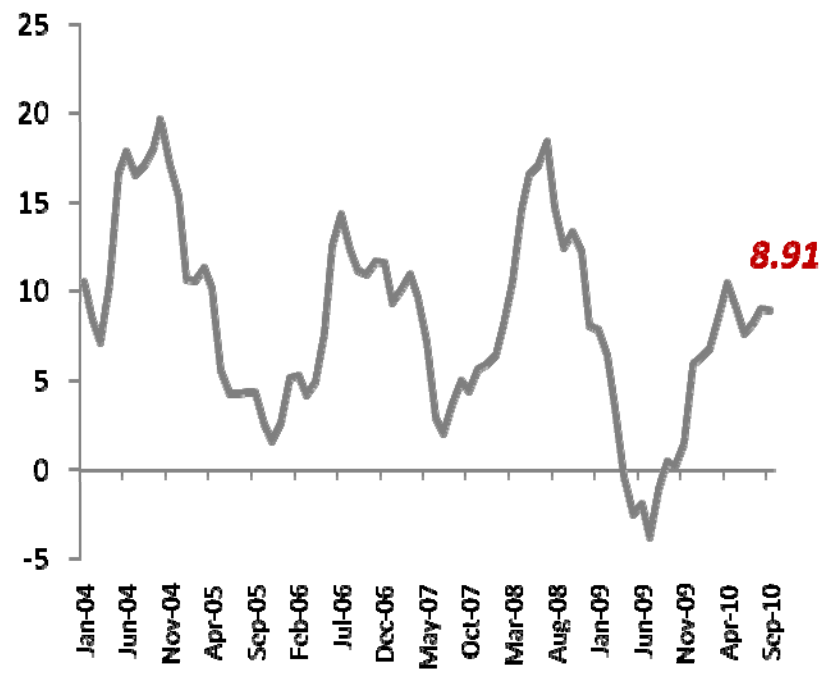
-  Food prices have had extremely high volatilities since the beginning of 2010. During May, June and July, food prices declined 7.5% in total. After these severe declines, in August and September the food prices rose sharply again.
-  Food prices in 1992-2002 and 2004 had a very similar trend to food prices in 2010.
-  According to trend analysis, increasing trend in food prices may continue with a decreasing pace.

Sources: Turkstat, VakifBank

**On a monthly basis, PPI climbed 0.51% in September following a 1.15% rise in August...**

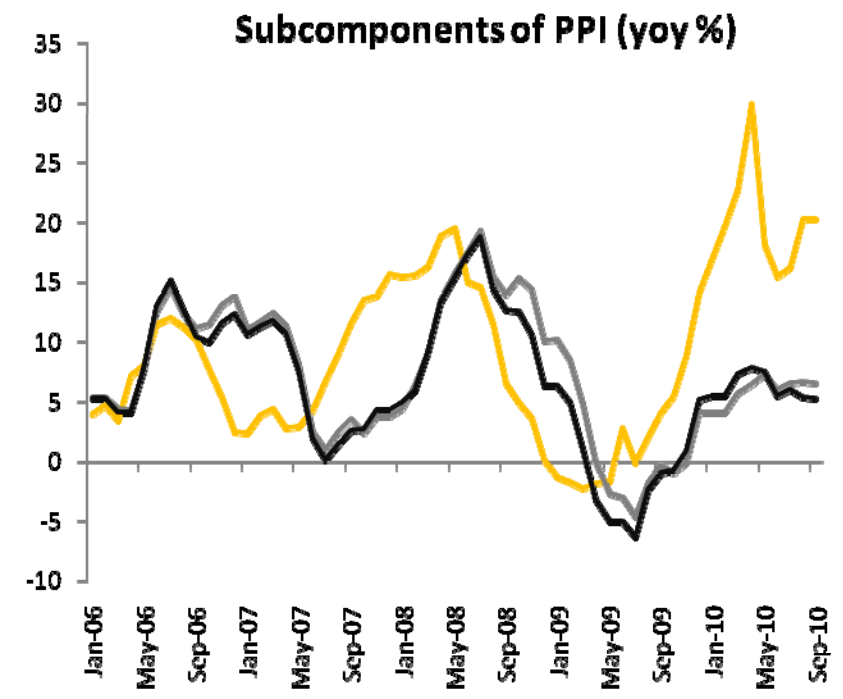


*While PPI increased on the monthly basis, yoy inflation slowed down from 9% to 8.9% in September. The strong increase in agricultural sector prices can be a risk for the food prices in CPI in the future.*



— PPI (yoy-%)

Sources: CBRT

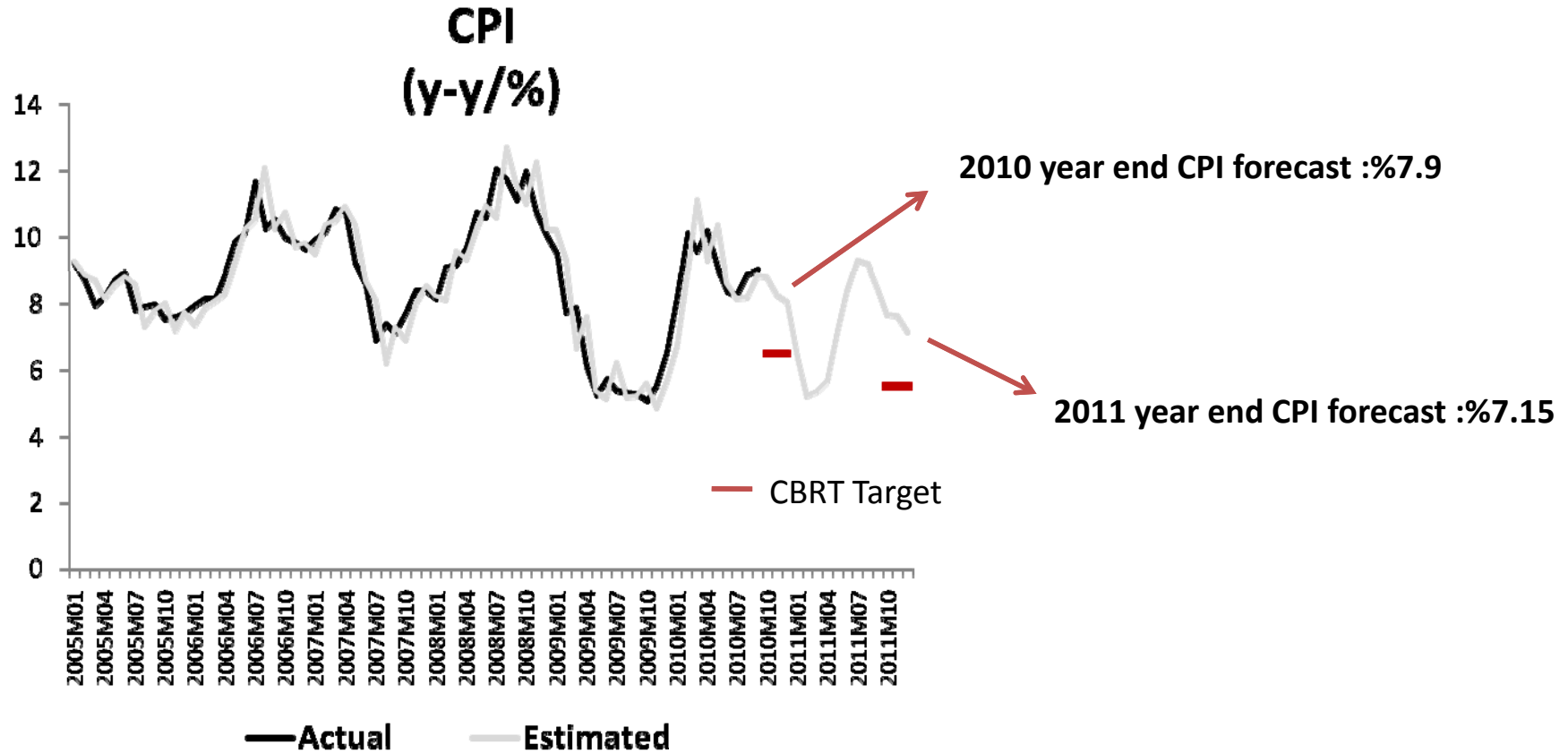


— Agriculture — Industry — Manufacturing

Sources: CBRT

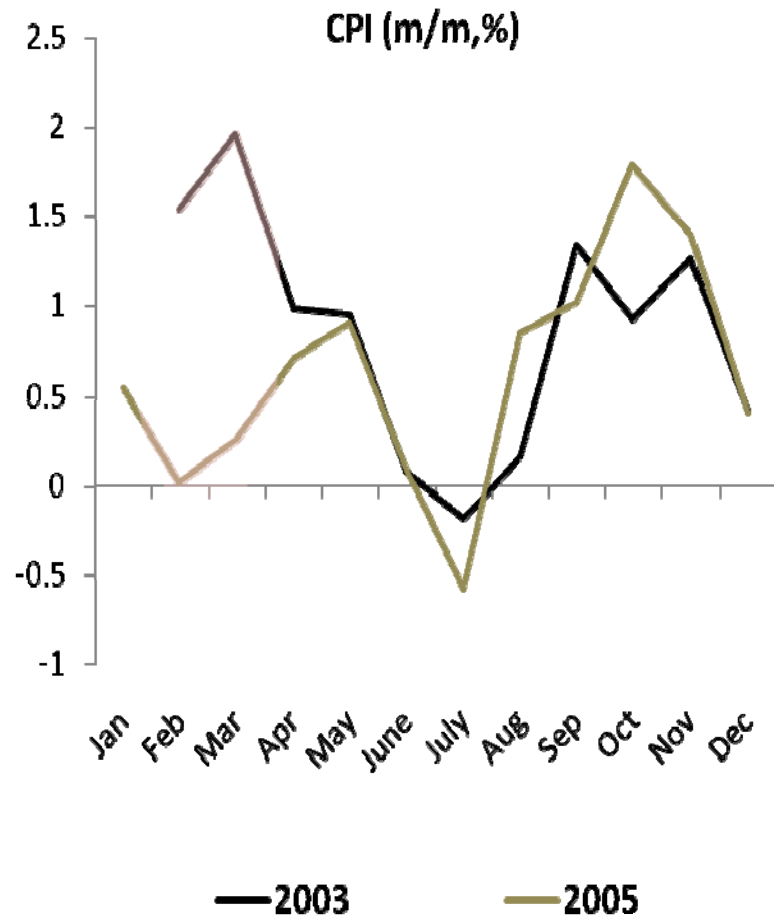
## Our 2011 CPI forecast stands at 7.15%...

According to our econometric model, after a sharp decline in the first quarter, inflation will move upward until the last quarter 2011. Within these expectations, by the end of 2011 our forecast is that CPI will be around 7.15%.



Source: Vakifbank,CBRT

# Risks and other scenarios for our 2011 inflation...



Source: CBRT, VakifBank

CPI (y/y,%)	Positive Scenario	Negative Scenario
Forecasts	5.5%	9.4%

5.5% CBRT target can be achieved under this scenario

There is an upper risk for inflation due to strong winter expectation during 2011.

## Positive Inflation Scenario:

The minimum inflation (mom) trends in the following years of high volatility in food prices are reflected to 2011.

## Negative Inflation Scenario:

The worst trends after 2001 crisis are reflected to 2011.



# What growth and inflation expectations suggest about monetary policy?

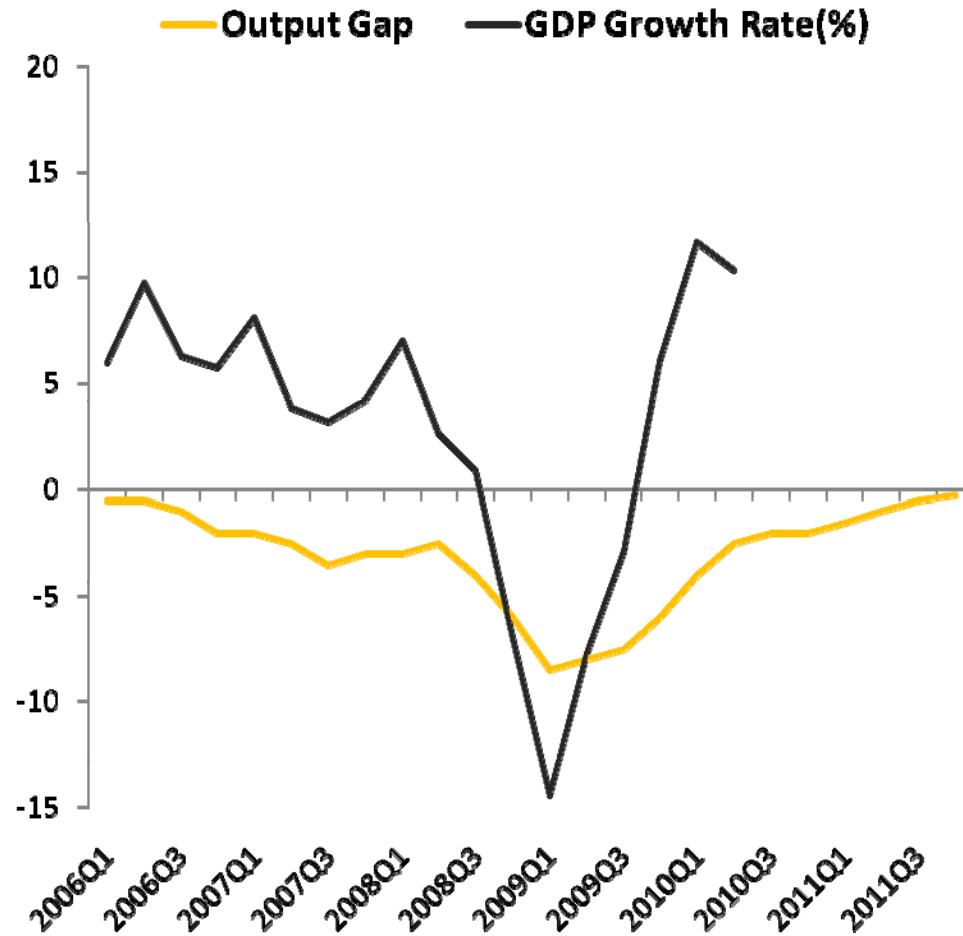
**To determine monetary policy outlook in 2011**

 **Output Gap**




 **Taylor Rule**

**will be analyzed in the next section.**

## Along with the recovery, output gap has likely turned back to pre-crisis level....

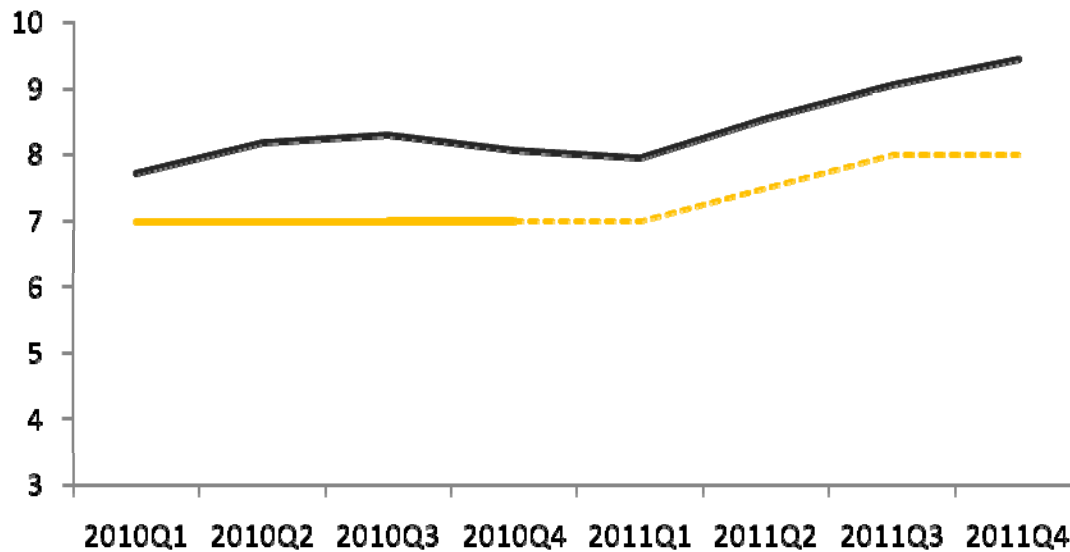


Source::CBRT

-  After output gap had peaked in the last crisis, it started to get narrow.
-  Turkish economy is approaching to the potential level of output.
-  Improvement in output gap signals there will be inflationary pressure in the future.

## Taylor Rule points out that CBRT will raise policy rate in Q2 2011...

### Taylor Rule



According to our expectations, CBTR will keep policy rate unchanged until 2011Q2 and Taylor Rule supports our forecast. However, uncertainties in external demand may force CBRT to postpone its first rate hike.

- CBTR Interest Rate (%)
- Taylor Rule's Expectations (%)
- - - Our Expectation

Source:CBTR

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