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Şeker Invest

Macronote

Inflation report-II:
Modest CBRT

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CBRT Governor Murat Cetinkaya presented Inflation Report-II

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.

A substantial output gap estimate revision: Output gap revised substantially to 1.6% from 2.0% in 4Q16 and 1Q17 from 1.7% from 2.2%. Only expected to fade away in 1Q19, signaling moderate growth expectation and relatively tight monetary policy.

Main Headlines:

- Loan growth is stronger than in previous years owing to macro prudential policies supportive of the financial system.
- 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. Although tax incentives stimulate the demand for houses, furniture and home appliances, the recovery in domestic demand fails to spread across all sectors.

Our Take on CBRT stance:

- Although QoQ GDP is likely to print a negative number in 1Q17, thanks to a positive carry-over effect from 4Q16 and the low base of last year, YoY GDP growth is likely to be noticeably higher than 4Q16's 3.5% YoY.
- We expect net exports to contribute 2 ppts to % YoY GDP growth, with private consumption will add another 2.0 ppts. We expect government-led

(construction) investment growth to push investment to 1 point contribution, making for minimum 5% GDP growth in 1Q16.

- We expect export-led growth to continue in the remainder of the year, with net exports adding 1.5 points in FY17. We expect consumption growth to be moderate at 2.5% YoY due to high inflation and low employment growth, adding around 1.0 percentage points to GDP growth. We believe that government-led investment is likely to add another 1 percentage point to GDP, bringing total GDP growth in 2017 to 3.5%.
- However, however recent astronomic rise in credit to SMEs was due to front-loaded and TRY has stabilized more than we expected and capacity utilization in the manufacturing sector thanks to robust export demand rose near 80% - close to its 2007 levels. As a result, private investment may be higher than our stagnation expectation. **A potential transmission of private sector investment and stronger than expected** export growth would wild cards in our estimate.
- On inflation, we are not as optimistic as the CBRT, given the volatility in output gap estimates, rapid and volatile credit and M3 growth and pent-up cost inflation, and finally volatility in food prices.
- The CBRT Governor stressed that they won't take into account food prices, or other one time price volatility in its policy decisions, **which we believe at odds with its efforts to contain deterioration in pricing behavior.**
- We believe food inflation could see as high as 15% in 2Q16 and 4Q16, risking further deterioration in pricing behavior. **We are in fact surprised with the CBRT's decision to keep food inflation unchanged at 9.0% and only 0.5% revision to headline inflation, despite a notable change in output gap estimates.** Thus, we maintain our 10% YoY inflation for 2017-end.
- **We believe Turkey has shown considerable success in re-balancing its external balances and reducing its dependence on borrowing external funds.** According to the CBRT's calculation; seasonally adjusted CA deficit has narrowed to USD2bn in February, which we believe could narrow towards USD1.0bn if current deceleration in the deficit continues going forward aided by deceleration in investment in machinery&equipment and low energy prices.
- **However, we believe general uncertainties regarding the output gap, high food price volatility and CBRT's discretionary reaction function will continue to be a wildcard regarding FX&FI pricing.**

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