March Inflation …

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.

Annual inflation rose to 11.3%

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)

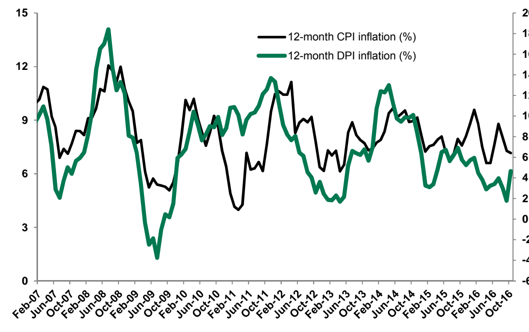
We believe dealers/retailers are still absorbing the rise in costs. Going forward, we expect to see more fx-pass-thru on core goods. In addition, services inflation will also trend higher due to higher food&energy and lagged effects of higher core goods prices. The dealers/retailers will eventually reflect 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 at -1.5%, food prices rose to 12.5% YoY from 8.7% YoY in February, led by high unprocessed food prices.

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.

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

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%.



CAD came in line with expectation in Jan…

CA deficit came in USD2.75bn, slightly above our expectation of USD2.50bn. The 12mth rolling deficit rose to USD33.2 (4.0% GDP), thus above the USD32.6bn of December.

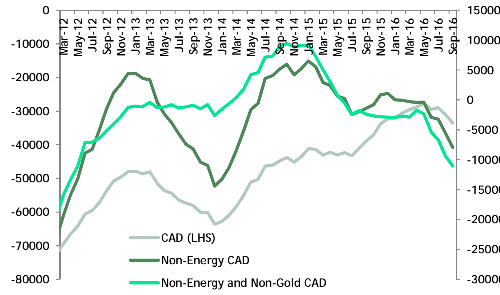
Hence, deterioration in the non-energy&gold CA deficit beginning in 2Q16, due to the loss of tourism revenues, has continued to improve for a second consecutive month, stabilizng at USD10bn.

We expect the FY17 CA deficit to widen only marginally to USD34bn (5.5% GDP) on the back of weak consumption demand and robust exports, despite higher oil&commodity prices.

FDI inflows were USD0.6b. The net portfolio flow as USD0.6bn (USD2.o Eurobond issue by Governemnt included). In terms of the breakdown through liabilities, non-residents' equity security transactions indicated a net purchase of USD0.65bn, while government domestic debt securities transactions saw a net outflow of USD0.80bn.

12mth rolling deficit at USD33.2 bn…

Net errors and omissions, on average at USD2.3bn over the 3 months before January reversed to negative territory with USD0.7bn outflows. A hefty decline in fx reserves of USD2.1bn (December 2016 decline: USD7.0bn) was observed.



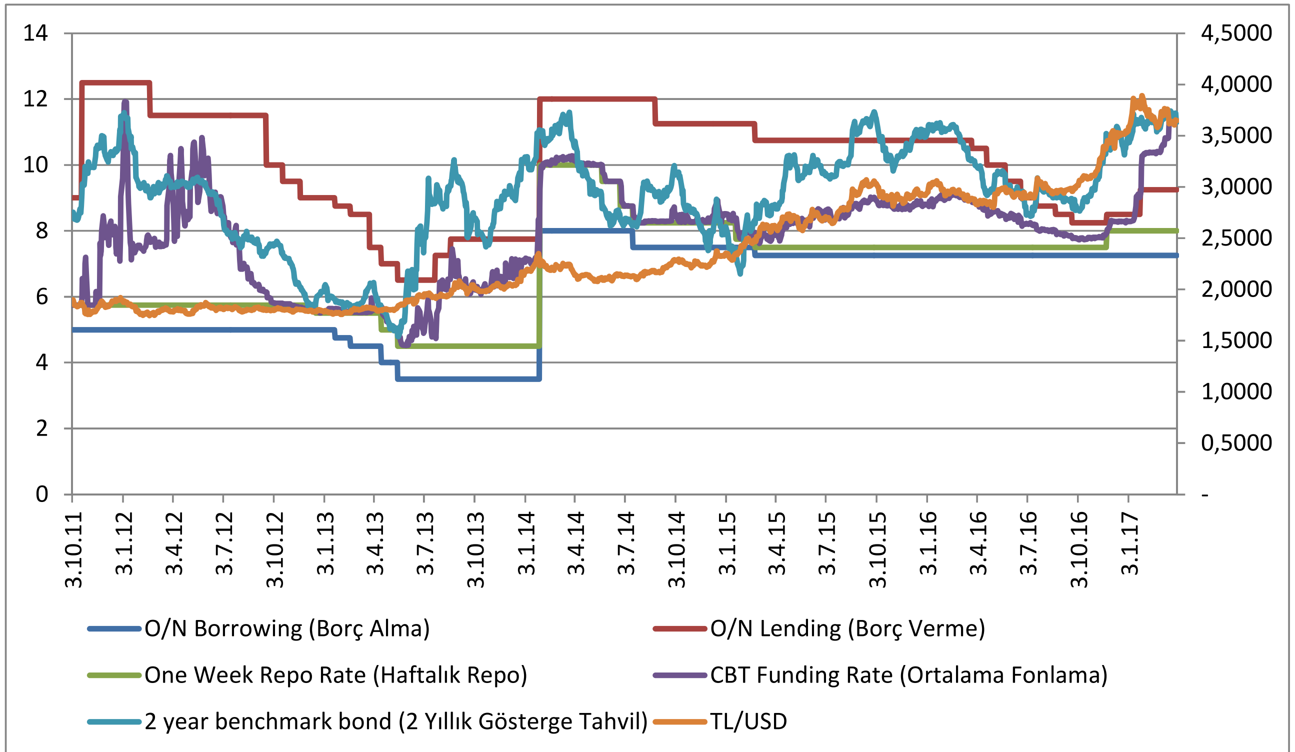
Central bank hiked late liquidity rate….

The MPC has raised the late liquidity window by 75 bps to 11.75%.

The MPC has left the 1-week rate (8.00%) and O/N marginal lending rate (9.25%) unchanged, but raised the late liquidity window by 75 bps to 11.75%. The main motivation as apparently signaled by the CBRT Governor was that inflation would rise significantly (in our view towards 12%) in 2Q17. The statement "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 kept unchanged as in the previous MPC note, pointing to continuing inflation pressures. However, the policy rate decision, we believe, has lost meaning to a large extent, as domestic loan&deposit rates have stopped moving in tandem with the policy rates, in fact stagnating since last autumn.

With 1Q17's credit boom to the private sector, more resilient than expected services consumption in 2H2016, despite exogenous shocks and robust export growth against a backdrop of buoyant global economy, we had revised our 2017 GDP growth estimate to 3.5% YoY from 2.5% YoY. This suggests that the negative output gap has been shrinking at a more rapid pace than previously assumed.

Given the supply&demand dynamics and weakened transmission mechanism, coupled with deterioration in pricing behavior, we expect inflation to continue picking up, going forward. This is despite our expectation that the average cost of funding could rise above 12% in 2Q17 (previously 11.50%) from the current 11.5%. Thus, we argue that inflation will remain in double digits in 2Q17 and 3Q17, with core inflation reaching double digits in the remainder of the year.



GDP 4Q16…
4Q16 *- 3.5% YoY vs. consensus (Seker) 2%*
FY16 - *2.9% YoY vs. consensus (Seker) 2%*

Revision:
3Q16 - *old -1,8% YoY vs. new -1,3% YoY*

Significantly higher than expected (2%) 4Q16 growth stems from dramatically higher than expected household consumption growing 5.7% YoY, contributing almost the entirety of 3.5% YoY GDP growth. Our expectation had been for a close to flat reading. We believe the consensus was not far off either.Even more strikingly, seasonally/calendar adjusted GDP was up 3.8% QoQ thanks to dramatic 5.8% QoQ expansion in private consumption (following 3Q16's 2.1% contraction), the highest quarterly growth figure since 3Q2010's 7.0% QoQ and also the third highest figure trailing 4Q2003's 6.2% QoQ since the series started in 1998.

One reason behind the gap was that 3Q16 household consumption was also revised to 1.7% YoY contraction from a much deeper 3.2% YoY contraction. Comparing 3Q16 and 4Q16, the main culprit behind the jump in consumption was very resilient services (accounting for half of total consumption) which grew 5.6% YoY. Neither the soft data, nor the deteriorating employment figures pointed to such resilient growth resulting in a wide divergence between the market and realization in GDP figures. Another intriguing revision was regarding public sector consumption. 24% YoY growth was revised significantly to 5.6%. As we had expected a similar reading in 4Q16, and the realized figure was much lower at 1% YoY, there was a big differential in our estimate. However, it was more than compensated by very robust household consumption.

With 1Q17's credit boom to the private sector, more resilient than expected services consumption despite exogenous shocks and robust export growth against a backdrop of buoyant global economy, we revise our 2017 GDP growth estimate to 3.5% YoY from 2.5% YoY.

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