



## EXECUTIVE SUMMARY

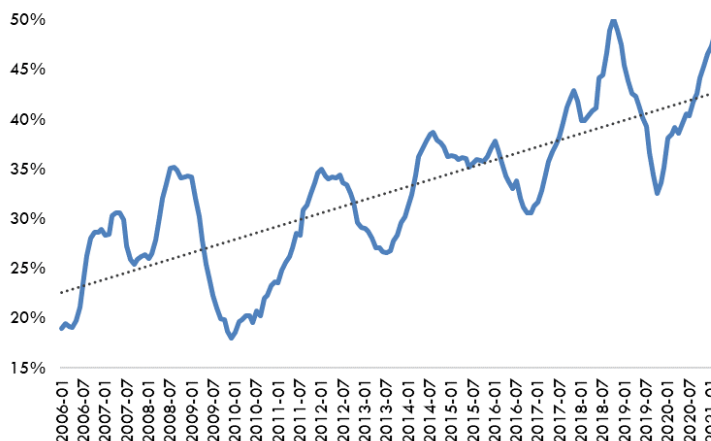
- Turkey's inflation rose slightly more than expected to 1.08% in MoM March. Core inflation (B and C Index), the better measure of underlying trend, stood at 17.5% and 16.9%, rising 0.6 and 0.7 points, respectively. Producer price increase reflects that the cost pressures continue to get stronger.
- The Purchasing Managers' Index (PMI) for Turkey's manufacturing sector hiked to 52.6, rising 0.9 points MoM in March. Index has been above the critical threshold in last 10 months.
- The CBRT's total reserves and net reserves declined significantly by \$3.2B and \$2.1B, respectively in the week of April 2.
- According to the Ministry of Trade's the preliminary estimates for March, exports climbed by 42.2% year-on-year to \$19B, while imports upsurged by 25.8%, reaching \$23.7B. Thus, foreign trade deficit fell to \$4.69B from \$5.47B in the same month previous year.
- Sales of passenger cars and light commercial vehicles in Turkey upsurged by 92.8% annually in March with the contribution of the base effect

## Peak in inflation will make it difficult to decide on interest rates

Turkey's inflation rose slightly more than expected to 1.08% in MoM March. Turkey posted a 0.57% monthly rise in consumer prices in March 2020. In addition, the historical average of the 2003- based index for March is at the level of 0.73% rise. These figures indicate that the base effect is slightly adverse for March. The main drivers of March's CPI increase was the price rises in non-food groups. Monthly hikes in education, health, hotel-cafes-restaurants, recreation-culture were the main drivers of March inflation. Also the rise in clothing prices more than the seasonal trend pulled inflation up significantly. Nevertheless, price increases in groups sensitive to the exchange rate (furniture, home textile, home appliances, audio-visual systems, personal care products, etc.) increased moderately except for medical products.

Thus, Turkey's annual inflation surged more than expected to 16.19% last month after rising 15.61% in February. In March, an increase of 0.09% was observed in the energy group which is above last year. Food prices rose 1.13%, less than 1.95% a year earlier. Although the annual rate of increase in food prices fell to 17.4%, this rate is still far above the historical average of food prices (10%) and the CBRT's Inflation Report food price assumption (11.5%). Core inflation (B and C Index), the better measure of underlying trend, stood at 17.5% and 16.9%, rising 0.6 and 0.7 points, respectively. In addition, the fact that the producer price increase reached 31.2% annually reflects that the cost pressures continue to get stronger. Also service inflation rose significantly to 12.6% on an annual basis with the contribution of the eased restrictions.

Inflation Diffusion Index



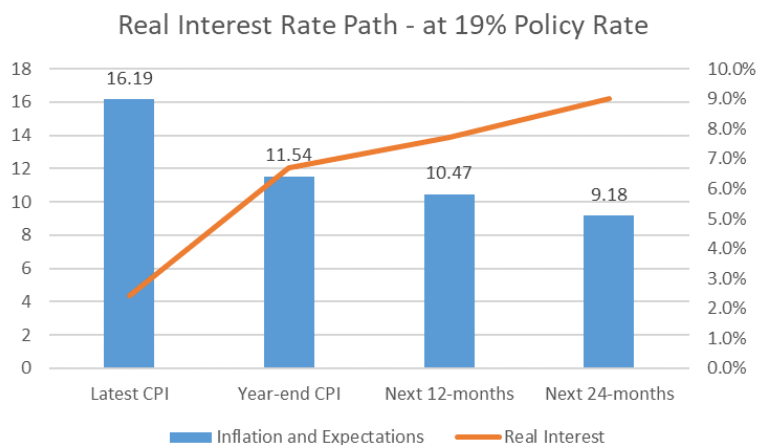
The unprocessed food prices dragged down the food inflation. Unprocessed food prices rose by 1.3% in March, compared with a surge of 3.1% a year earlier. In February, the "Inflation Diffusion Index", which we calculated by proportioning the difference between the prices of products and services within the scope of the index, which consists of 415 items in total, to the total number of items, increased by 47.2% compared to the previous month, while its average for the last 12 months in the graph increased to 48.6%. In the graphs related to inflation trends and diffusion index updated after inflation, the CBRT reflected that the B and C trend indicators (seasonally adjusted monthly change, quarterly average, annualized) slowed down to around 20% and 18%, while the service inflation trend rose above 15%.

The adverse effects of global food, oil and commodity prices on the course of inflation in the short term continue. Moreover, exchange rate volatility and developments in import prices continue to adversely affect the course of inflation. In addition, the economic activity closing the first quarter without being much affected by the monetary tightening and the minimum wage increase, which is well above the inflation target, keep the risks on inflation outlook upside. Therefore, even if the depreciation of the TL does not deepen, the peak in inflation can be reached in the range of 18-19% in April or May. Then, with a gradual decline, inflation may decline to 14% at the end of the year. The recent surveys predicted the end-2021 inflation is expected to reach 12.5%. Former CBRT Governor Agbal raised the one-week repo rate by 200 bps to 19% at the March MPC meeting, while reiterating the message that the tight monetary policy stance will be maintained for a long time and additional tightening can be made if necessary until a permanent decline in inflation is achieved.

Yet Turkey's surprise decision to fire Agbal has jumped uncertainty and inflamed concerns about return to unorthodox policies. After all, Turkey faced sharp portfolio outflows and the Turkish Lira crashed. The new Governor, Mr. Kavcioglu emphasizes the continuity in policies since the day he took office and gives the message that "until strong indicators that point to a permanent decline in consumer prices are formed, the policy rate will continue to keep its benchmark policy rate above inflation."

As a result, we are of the opinion that the CBRT will most likely not change the policy rate at the following MPC meeting. As well, the CBRT forecasts for the inflation path in the Inflation Report, which will be announced on April 29, will enable us to obtain more clues regarding the monetary policy to be implemented in the upcoming period.

On the other hand, the policy real interest rate calculated according to the actual inflation slipped to 2.4%, while the real interest calculated according to the expected inflation (next 12 months) stood at 7.7%. The repeated message of the CBRT on how to set the policy rate means that the policy rate will be determined in a way to ensure a strong disinflationary effect. Considering the rising CDS premiums in Turkey, this ratio should not be lower than the 2-3% range. However Turkey has already reached the middle of this range. Considering that inflation will rise to the range of 18-19% in April or May, the real interest rate will be insufficient. In addition, the fact that the current increase in inflation and exchange rates will increase the year-end and 12-24 month expectations in the upcoming period indicates that the CBRT should not even think of the policy rate cut.



## Turkey's manufacturing PMI index was stronger in the first quarter

The Purchasing Managers' Index (PMI) for Turkey's manufacturing sector hiked to 52.6, rising 0.9 points MoM in March, according to a report by the Istanbul Chamber of Industry prepared in cooperation with London-based global data firm IHS Markit. A PMI reading above 50 indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting. The Index was below the critical threshold for three consecutive months due to Covid-19. However it has been above the critical threshold in last 10 months. "Total new orders returned to growth, ticking higher in March following a slowdown in the previous month. Panellists reported signs of improving demand, while new export orders rose for the third month running and at a faster pace than total new business." the report noted. The report also highlighted, that the higher new orders and the addition of new production lines supported and the rate of expansion quickened slightly, yet there were some reports that raw material supply shortages had prevented a stronger increase in output. Thus, problems in supply chains were reported again, with difficulties sourcing raw materials and issues accessing shipping containers contributing to a sharp lengthening of suppliers' delivery times.

On a sectoral basis, six of the ten sectors increased production in March, thereby an improvement recorded compared to the previous month. As in the first two months of the year, the fastest expansion in production took place in the base metals sector in March. It was also noteworthy that the food products and clothing and leather products sectors returned to the growth zone. The first quarter average of the new year indicates that the recovery continues with 52.9. As a result, the fact that overall Turkey PMI remained in positive territory suggests that the growth in the manufacturing industry continues, largely maintaining the momentum achieved in the second half of last year. On the other side the ongoing slowdown in credit volume caused by monetary tightening may slow the growth rate.

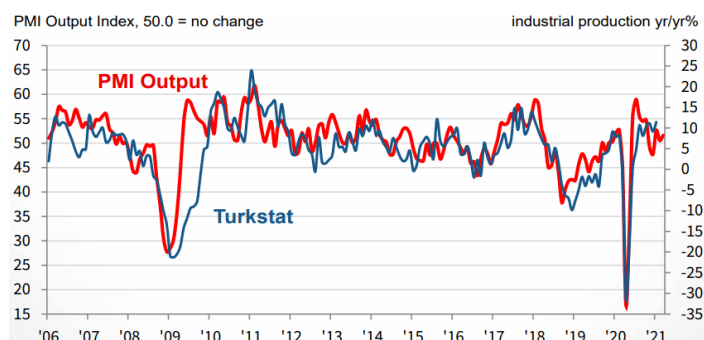
## CBRT's total & net reserves decreased significantly in the week of April 2.

Based on the CBRT's weekly foreign currency changes data, in the last week (26 March), total reserves fell by \$2.5B. Gold reserves increased by \$483M, whereas gross foreign currency reserves declined by \$3.4B. Despite the decrease in ounce in the relevant week, the gold reserves owned by the CBRT increased by \$514M. Thus, total gross foreign currency reserves and total reserves decreased to \$50.9B and \$90.6B, respectively. Also Net International Reserves (NIR) stood at \$12.8B, down by \$887M. In the relevant week, FX and gold swap transactions made by CBRT's long term tenders and weekly transactions stock stood at \$42.8B, down by \$2B WoW. In addition, in the relevant week, the Treasury borrowed \$1.2B with gold-denominated bond and lease certificate issues on March 24.

Last week's (April 2) reserve developments will be announced on Thursday. But we have the same week's analytic balance sheet. Foreign assets and total foreign currency reserves are closely related with each other thus, we expect that; in the relevant week, total reserves (including gold) will stand at \$87.4B, down by \$3.2B.

As mentioned above, the change in the banks' foreign currency deposits is important for the liabilities in terms of NIR. In that week, banks' foreign currency reserves decreased by \$1.1B. Besides, public foreign currency deposits are followed as internal liability, therefore despite the increase of external assets, foreign liabilities will not be changed and NIR level is provided to be higher than net foreign currency position.

In the same week, no change was observed in public foreign currency deposit. Yet, the Treasury had a \$2B Eurobond redemption on 30 March. Therefore, magnitude of NIR will drop by \$2.1B to the level of \$10.7B.



## **Credit card spending growth rate at its highest level since November 2018**

Change CBRT's weekly data of "Debit Card and Credit Card Total Expenditure Amount", in the week ended by March 26, shows that total transaction stood at \$26.2B, down by 0.7% last week. In the relevant period tax and private pension payments (total TRY0.5B) were the factors that had an upward impact this time. For this reason, we have already started to show the trend of expenditures, excluding taxes and personal retirement insurance payments.

Hardest weekly decrease was experienced in the health, clothing, grocery, furniture- decoration, construction materials and service sectors. On the other hand, spending on electric- electronic and stationery rose during the same period. Hence, the annual change of average expenditure for the past four weeks jumped to 42.6%, the highest rise since mid-November with the contribution of base effect. On the other side shopping made over internet which is explained separate from these transactions rose to TRY7.3B by a weekly increase of TRY0.5B. The annual change in the average of total shopping including the Internet for the last 4 weeks also increased to 51.9%. Therefore, the annual change in the average of the last 4 weeks of total shopping excluding tax and personal retirement insurance payments, including the internet, which we track as a better indicator to reveal true underlying trends, rose up to 55.9%. In 2020, as a general, total credit card expenses rose by 13% compared to previous year. In the second half in which the domestic demand was the strongest, the annual rise reached up to 50%. Later on, the slowdown which continued until the last week of December was replaced by an improvement in the following period. Credit card expenditures are being followed closely as an important indicator of domestic demand.

## **Very strong exports in March, whereas no slowdown in imports**

According to the Ministry of Trade's the preliminary estimates of March foreign trade, exports climbed by 42.2% year-on-year to \$19B, while imports upsurged by 25.8%, reaching \$23.7B. . Thus, foreign trade deficit fell to \$4.69B from \$5.47B in the same month previous year. Exports in March pointed a strong annually growth with the contribution of the workday surplus and the base effect, reflecting the ongoing recovery in foreign demand.

The substantial rise in total imports also continues. Imports of intermediate goods rose up by 25.1% annually, while imports of intermediate goods excluding energy and gold jumped by 40%. These outcomes remark to a strong course in terms of industrial production. Yet, the 18% annual rise in consumption goods imports and the 38.3% annual increase in motor vehicle imports did not give a positive signal for normalization in domestic demand.

On the other hand, the fact that the total imports of machinery and electrical machinery increased by 49.9% compared to the same month of the previous year, being stronger than the increase in total investment goods imports (36.1%) indicates that the recovery in private investments in the second half of last year continues. Thus, imports of investment goods, consumption goods and intermediate goods increased 36.1%, 8% and 8%, respectively, in Q1 2021 compared to the same period of the previous year. As a preliminary estimate, we expect the current account deficit for March to fell from \$5.4B to \$3.9B in the same month of the previous year and the 12-month rolling current account deficit to show a downward trend again.

## **Car sales at full speed**

Sales of passenger cars and light commercial vehicles in Turkey upsurged by 92.8% annually in March with the contribution of the base effect, according to data released by Automotive Distributors' Association. A total of 96.428 vehicles were sold across Turkey last month, the Automotive Distributors' Association said. Besides, the automotive market stood at 198.660, rising 59.7% in Q1 2021. The statement also reported that last month the best March in total and the best quarter in number of cars were achieved.

## **CBRT's total swap with banks continued to decline**

The Central Bank's total OMO funding fell to TRY3460B, TRY64B was provided by one week repo (19%) tender. Therefore, the average funding cost closed by 19%. Meanwhile, upon CBRT's withdrawn liquidity amount through 17.5% quotation rose to TRY6.3B, whereas net funding amount dropped to TRY339.7B.

On the other side, \$366M of transactions were made in CBRT Turkish Lira Currency Swap Market one-week maturity. In addition, with the three-month swap auction, TRY1B equivalent liquidity provided at 17.9% interest. Thus, FX swap stock reached \$30.7B. Total transaction amount in CBRT's Turkish Lira-Gold swap was closed with a transaction of 11879kg. The short position amounted to \$5.2B. Istanbul Stock Exchange (ISE) transactions amounted to \$500M yesterday while the swap stock declined to \$6.6B, the CBRT data showed. The total short position reduced to \$42.4B at the end of the day.

### **Today 10:00 AM – GMT+3**

- The Central Bank of Turkey will announce its inflation assessment for March. The CBRT's evaluations on the inflation trend calculated from seasonally adjusted data not disclosed by TURKSTAT may draw attention.

### **14:30 PM – GMT+3**

- Turkey's Real Effective Exchange Rate for March will be announced by the CBRT. Despite the fact that the nominal monthly change of the average exchange rate basket in March surged by 7%, since inflation increased by 1.08% in the same month, we expect the index to decline from 69.7 to 65.5.

#### **Contact information**

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