

EXECUTIVE SUMMARY

- Inflation climbed more than expected with an increase of 1.68% in January, the annual CPI rose to 14.97%. While core inflation indicators rose to 16%, services inflation eases to 11.5%.
- Weight of food increased in the inflation basket, whereas the weight of items such as alcoholic beverages, clothing and restaurants decreased. TURKSTAT announced that daily prices were started to be collected from chain markets with barcodes.
- BRSA daily figures indicated that in the week ending January 29, the volume of FX deposits deteriorated by \$640M to \$258.3B.
- Treasury borrowed €1.5B by issuing Euro-denominated bonds and lease certificates.
- Health Minister Fahrettin Koca said, "Except for the UK variants of the coronavirus transmitted to 196 people in our country, two of our citizens were faced with the South African variant, and one of our citizens the Brazilian variant of COVID."
- Today, at 10:00, the CBRT will publish its January inflation assessment. At 14:30, the CBRT will announce the Real Exchange Rate Index for January. (GMT+3)

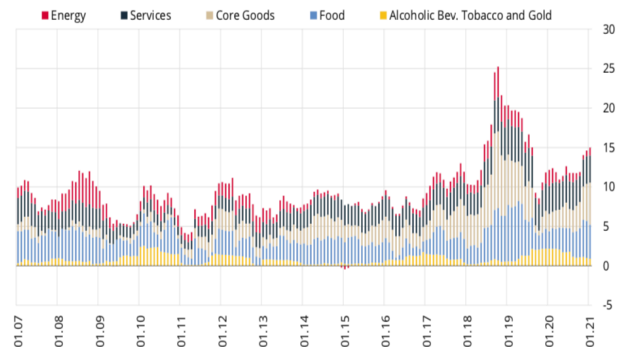
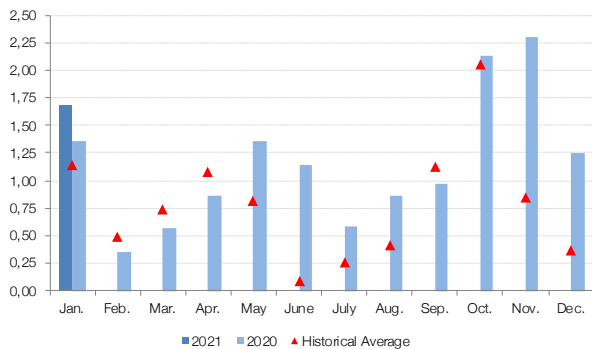
Worst is yet to come in inflation

Turkey's consumer price index (CPI) rose by 1.68% in January, above the median estimation (1.53%) and the historical average for January (1.1%), while the 2003-based index was the highest January inflation since 2017. Thus, the annual CPI rose from 14.6% to 14.97% in the previous month. The major items responsible for the rise in inflation compared to last year was the non-food groups. As a result, significant increases in housing, household goods and transportation groups led to the rise, and the more limited deterioration in clothing prices than the seasonal trend also strengthened the rise. In addition, high price increases were again observed in many groups sensitive to the exchange rate and domestic demand (furniture, domestic textile, household appliances, personal care products, etc.)

Food prices hiked by 2.48% in January, less than last year. However, the annual hike of 18.1% in food prices was far above the CBRT's forecast of 11.5%.

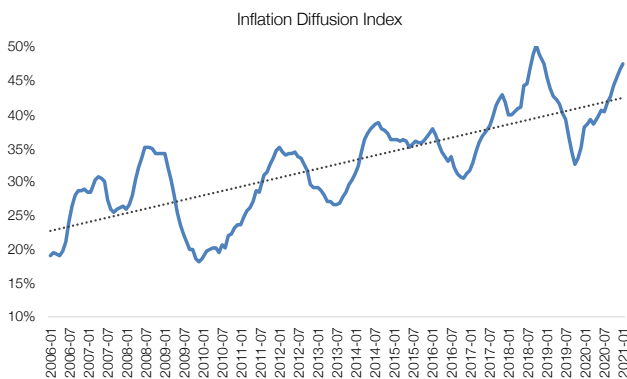
In the energy group, an increase over the previous year was observed with 3.24%. In addition, there was an growth in core inflation on a monthly basis far above the long-term averages, and core inflation (B and C index) rose to 16% and 15.5%, respectively. In addition, the increase in the domestic PPI annual change pioneered the pressures from this channel, and the price change of intermediate goods which is the main input for production, to 26.2% and 34.1%, respectively. On the other hand, the service inflation dropped to 11.5% with a limited annual decrease, we see that the "other services" group, which was driven down by the low revaluation rate of 9.1%, was effective at this rate.

In the meantime, price increases are observed in rents, restaurants-hotels, transportation and communication as well. Increase in the weight of unprocessed and processed food prices in the index in January positively contributed to the annual change in headline inflation.



Price decline of 1% in the fruit and vegetable group was the opposite of previous year's 20.3% of increase. Also 2.4% of rise in other unprocessed foods prices, including meat prices, was higher than last year. The annual rise in processed food prices stemmed from the other processed food group excluding bread and cereals. On the other hand, high price increases were observed in items that are sensitive to exchange rates and domestic demand such as furniture (6%), domestic textiles (1.9%), household appliances (1.7%), medical services (5.5%) and personal care appliances (3.2%).

The general propagation trend of inflation seems to continue to get stronger. In January, the "Inflation Diffusion Index", which is calculated by proportioning the difference between the products and services within the scope of the index - includes 415 items - to the total number of items, climbed slightly with 43.6% compared to the previous month. This significantly exceeded the rate of 33.5% in the same month of the previous year and the average of 12-month rolling continued to rise with 47.4%.



Similarly, the Dispersion Index of the CBRT continued its negative course as seen in the graph. In the graphs, it is reflected that trend indicators B and C (seasonally adjusted monthly change, quarterly average, annualized) rose to 24% and 22%, respectively. Services inflation trend rose to 14%.

The rise in global food, oil and commodity prices also contributes negatively to the short-term trend of inflation. However, making adjustments to the prices set by the public, taking into account the inflation target, seems to have limited the upward pressure from this channel. The recent appreciation of the TL caused the currency basket to decline by 3.5% from the beginning of the year and indicates that the upward effect of this factor on inflation may diminish over time. On the other hand, economic activity and domestic demand were not affected by the monetary tightening in the first month of the new year and the minimum wage increase, which was well above the inflation target, keeps the risks on inflation upward. Therefore, in the absence of a significant depreciation of TL, inflation can be expected to remain in the range of 15-17% in the first four months of 2021, and then gradually decrease to end the year in the range of 11-12%. From the chart included in the Inflation Report of the CBRT, it is understood that the inflation expects a gradual increase until April and to see the peak with 15.5-16% as the midpoint (17.5-18% as the upper limit). In this process, if there is a deviation from the forecast range, it may be inevitable for the CBRT to tighten additionally.



As for the implications of inflation realizations in terms of monetary policy stance; CBRT did not change the one-week repo rate to 17% at its January MPC meeting, it was given the message that the tight monetary policy stance would be maintained for a long time until a permanent decline in inflation was seen and that additional tightening could be made ahead if necessary.

In addition, it was stated that in terms of the course of inflation, the compliance of indicators regarding the underlying trend of inflation and pricing behavior, diffusion indices, demand and cost factors, and inflation expectations within the forecast horizon will be closely monitored. In the first Inflation Report of 2021, the upside risks on inflation were emphasized and the forecasts were unchanged, strengthening the tight stance. Chairman Agbal stated at the press conference that it was too early to talk about the rate cut which caused the market's rate cut pricing to be delayed a little. Therefore, it can be said that the CBRT will remain on standby, and will decide on the next step by following the compliance of inflation with the permanent decline criteria, especially in the first four months. In this case, considering the current growth and inflation trend, it seems premature to take an interest rate cut before the last quarter.

On the other hand, policy real interest rate calculated according to the inflation realized after the decision decreased to 1.8%. The real interest rate, calculated according to the expected inflation, is at the level of 5.9%. As it will be remembered, in the new monetary policy strategy announced in the CBRT Inflation Report, The message was given, "The level between the actual / expected inflation rate path until the target of 5% and the monetary policy interest rate path will be established by considering a strong disinflationary balance and this balance will be maintained continuously". Thus, it was emphasized that, quite similar to the reasonable real interest rate targeting applied in the previous period, the policy rate will be determined above the course of the actual and expected inflation, although it is not formulated in figures, in a way that will provide a strong disinflationary effect. The real interest rate should not be less than 2% considering Turkey's high CDS premium.

According to January inflation, it fell below this level and if we assume upward trend will continue until April, the real interest will decrease even more. However, if the inflation in the upcoming period does not increase the year-end and 12-24 month expectations drastically, the CBRT may see the current level of the policy rate sufficient.

Changes in inflation measurement due to the pandemic

In January, the updates regarding the item weights in the inflation basket have also been announced. Weight of food increased in the inflation basket, whereas the weights of items such as alcoholic beverages, clothing and restaurants were reduced. The weight of the food, which was 22.77% in the basket in 2020, was up to 25.94%. The weight of transportation, which is the second largest item after food, fell from 15.62% to 15.49%. The weight of the house increased from 14.34% to 15.36%. Along with food and housing, household goods, communication and health groups have also increased their weight in the inflation basket. The biggest downward revision was in the restaurant and hotels group. The weight of the restaurants and hotels group in the inflation basket decreased from 8.67% to 5.91%.

In addition, the revisions implemented to the CPI data compilation processes are also mentioned below; Barcode (sales) data obtained from chain markets, which have an important share in the retail trade sector, started to be used in the CPI calculations for 2021. Thus, instead of prices compiled from the field on certain days of the month, prices covering the whole month were included in the index by using daily sales and quantity data on the basis of branches from companies.

Limited decline in FX deposit volume due to Euro/\$ parity and gold prices, Foreigners' Government Domestic Debt Securities (GDDS) purchase continues

The data announced by the BRSA for the banking sector on a consolidated basis and on a daily basis indicated that the volume of FX deposits decreased by \$640M to \$258.3B in the week ending January 29. Natural entities and legal entities dropped by \$14M & \$490M respectively. In the relevant week, the parity declined 0.3% and the gold ounce value 0.5%. On the other hand, the TL-denominated GDDS portfolio held by non-residents hiked by \$430M last week. Banking loan volume rose by approximately TRY2B in the same week.

Treasury's borrowing in Euro

The total sales of 3-year Euro-denominated bonds and lease certificates issued by the Treasury amounted to €1.5B (TRY12.9B) yesterday. This month, a gold-denominated bond and lease certificate will be issued. The total sales target of both issues was TRY16B. According to the three-month domestic borrowing strategy announced by the Treasury, a total of TRY45.4B of domestic borrowing, TRY44.3B of which is from the market, is anticipated in February, and TRY45B will also be redeemed in return.

Contribution of restructuring to the budget

Within the scope of the Law on Restructuring of Taxes and Some Other Receivables, an application was made for TRY210B of the receivables totaling TRY500B. TRY110 B of 210B was tax receivables, TRY90B of which is SSI's premium receivables. Within the scope of the structuring law, a debt of TRY500B, TRY289B tax, TRY165B premium and the remaining receivables were included. An application has been made for 210B TL of a total of TRY454B of tax and premium receivables. Taxpayers who want to benefit from the interest rate cut of the restructuring have made a total cash payment of TRY6.8B, TRY2.75B of which is premium.

Continuous restructuring in recent years has contributed significantly to budget revenues. For example, collections made within this scope reached TRY1.4B in 2018, TRY17.1B in 2019 and TRY4.2B in 2020.

CBRT swap position declined

Total open market operations (OMO) funding of the Central Bank declined to TRY280B, TRY54B was obtained with a weekly repo (17%) auction. Thus, the average funding cost was 17%. In the meantime, the amount of liquidity withdrawn by the CBRT with 15.5% quotation soared to TRY7.5B. The net funding also dropped to TRY272.5B. Overnight repo interest rate dropped by 17.39% compared to yesterday, and was above the CBRT's policy rate. On the other hand, \$250M of transactions were made in the CBRT swap transactions with the weekly maturity. Thus, FX swap stock was \$31.8B. Total transaction amount in CBRT's Turkish Lira-Gold swap market reached 276 kg. Open position amounted to \$6B. Swap stock shrank to \$3.9B & \$500M of transactions were made by BIST yesterday, Central Bank announced. The total open position at the end of the day declined to \$41.7B.

Mutations and COVID variants in Turkey

According to the statement made by the Ministry of Health, the number of new cases of Covid-19 in the last 24 hours was 8.1K, the number of patients was 632, the death toll dropped to 117, the total number of cases was 2.5M, the total death toll reached 26.3K people. While the number of new cases and the number of new patients rose, the number of deaths decreased compared to yesterday. On the other hand, considering that the number of new cases is a leading indicator in terms of deaths, it was a negative sign that the average of the last 14 days rose to 6.7K for the last four days. On the other hand, the number of deaths per patient did not change at 3.9%, while the number of patients per test did not change at 0.4%, although the number of tests performed increased. While the rate of pneumonia in patients announced by the Ministry of Health did not change with 4.9%, the number of severe patients continues to drop with 1.5K.

No need to get excited, Presidential Government System continues

Regarding the new constitution to be drafted, President Erdoğan said, "The Presidential Government System will be built on the historical breakthroughs we have brought to our country." said. Erdogan, who attended the party's regular provincial congresses, said, "We will lead the work on the new constitution with our partner in the People's Alliance. We welcomed the positive statements and the framework that Mr. Bahçeli made on this issue yesterday." said. Erdogan's call for a new constitution, despite the insufficient number of seats of the Republican alliance, was interpreted as "the bankruptcy of the system" by the spokespersons of some opposition parties in the lobby, "revision of the presidential system can be made".

According to the news published in the BBC Turkish, AKP(Justice and Development Party) sources state that changes can be made in the constitution that will allow harmonization with the new system or the functioning of the boards more easily, but that the provision regarding the "election of the president with 50 + 1" is out of question.

The focus is on joint constitutional amendment work with the MHP within a certain timetable. It is planned to bring the prepared constitutional amendment text to the opposition, and to present the constitutional amendment proposal with the MHP under the chairmanship of the Assembly, even if the opposition parties oppose.

Mathematically, it is not possible for the AKP and MHP to pass the joint constitution proposal to the Parliament without the support of the opposition parties, which make it a prerequisite to "abandon the presidential system". (There is no problem in presenting the Constitution to the Parliament, only 289 votes of the AK Party are more than enough. However, when it comes to finding 360 deputies who will lead the Constitution to a referendum, the problem begins. When the MHP has 48 votes and 1 vote of the BBP is taken into account, the number is 338; so there are 22 openings) AKP's hope on this matter is in the deputies who are calculated not to abide by their parties' decision in the "secret ballot" to be held for constitutional amendment.

In this regard, it is stated that some regulations that will meet the opposition's expectations can be included in the constitutional amendment package. The possibility that the constitutional change will not pass through the Parliament if opposition support is not provided is also considered. Even if the constitutional amendment is not recorded live, it is spoken and even Turkey would relieve the discussion, noted that soften the political climate. In addition, it is calculated that the opposition, which is looking for a common ground on the parliamentary system, will be politically cornered if it says "no" to the new constitutional amendment.

The Constitutional Court once again caused some raised eyebrows

The Constitutional Court has completed the justification of the decision of the Istanbul 14th Heavy Penal Court, which did not implement the decision on Enis Berberoglu, a CHP, which he wanted to be tried again, caused a new violation of rights. In its unanimous decision, the court stated that the local court disregarded the constitution and that Berberoglu maintained the status of convict arbitrarily. In the decision, it was stated that the rule of law cannot be mentioned in an environment where the decisions are not implemented, that this concept is not just rhetoric, and it was underlined that protecting the constitution is not only the duty of the Constitutional Court. Therefore, in the decision, the Parliament and the Council of Judges and Prosecutors, to which a copy of the decision was sent, were also invited to duty. In the decision, it was emphasized that it was necessary to initiate a new trial against Berberoglu and to give a "stop" decision due to his "immunity". It was also implicitly pointed out to the Turkish Grand National Assembly that after this procedure, Berberoglu should take the necessary steps to gain the parliamentary membership. In the decision, the HSK was implicitly given the message that it should open an investigation regarding the court.

The Speaker of the Turkish Grand National Assembly Mustafa Sentop, on the other hand, stated that the AYM (Constitutional Court)'s Berberoglu decision, in which he reminded his duties and powers, stated that there was a section that could be called a "political declaration" and said, "AYM has not made a decision in the judgment part that the Turkish Grand National Assembly should do this. It is not among the duties and powers of the AYM. It is clearly an override to give advice," he said. After this statement, the Presidency of the Turkish Grand National Assembly returned the reasoned decision of Enis Berberoglu, sent by the Constitutional Court.

How will the CBRT read inflation?

Today at 10:00 (GMT+3), the CBRT will release the inflation assessment for January. CBRT's evaluations regarding the basic trend of inflation and especially the developments observed in the inflation trend calculated from seasonally adjusted data not disclosed by TURKSTAT may attract attention.

There will be a significant increase in the Real Effective Exchange Rate

Today at 14:30 (GMT+3), the CBRT will announce the January Real Effective Exchange Rate Index. Although the average monthly change in the average currency basket decreased by 4.1% in January, we expect inflation to rise by 1.68% in the same month, from the previous value of the 100-based index in 2003 to about 66 from 62.34.

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