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Turkish Inflation Jumps Most Since 2002, Undermining Policy (2)
2011-06-03 09:59:29.970 GMT

(Updates with global food inflation in eighth paragraph,
economist's comment in 10th.)

By Steve Bryant and Ali Berat Meric

June 3 (Bloomberg) -- Turkish inflation accelerated by the most in almost a decade, undermining the central bank's argument that it can restrain growth and prices without raising interest rates. Bonds weakened the most in two months.

Inflation surged to 7.2 percent in May from 4.3 percent a month earlier, the statistics office in Ankara said on its website today. It was the biggest increase in the annual rate since January 2002 and exceeded all the forecasts in a Bloomberg survey of 12 economists, the median of which was 5.7 percent. In the month, prices rose 2.4 percent.

The central bank had predicted that May inflation would exceed the year-end goal of 5.5 percent. The bank is seeking to restrain credit growth in an economy that expanded 8.9 percent last year and argues that higher reserve requirements for banks can do the job without raising interest rates. The benchmark one-week repo lending rate has stayed at a record low of 6.25 percent since January.

"Inflation and the current-account positions are flashing red lights and suggesting clearly that the economy is overheating," Tim Ash, head of emerging-market research at Royal Bank of Scotland Group Plc in London, said in an e-mail.

"Turkey needs fiscal and monetary policy to be more aggressively tightened now."

Yields on benchmark two-year lira bonds rose as much as 27 basis points to 9.02 percent, the biggest increase since March 23. Yields gained 21 basis points to 8.96 percent at 12:02 p.m. in Istanbul.

Low-Rate Policy

The bank's low-interest-rate policy is designed to deter short-term inflows and prevent the lira from strengthening. The currency has weakened almost 3 percent against the dollar this year, increasing the price of imported goods. Oil prices have risen about one-third in the last year.

Inflation slowed to a four-decade low of 4 percent in March and has accelerated since then. Core inflation, which excludes energy, food and tobacco prices, accelerated to an annual 4.7 percent in May from 4.4 percent a month earlier.

Clothing prices jumped 11.7 percent in May and food prices rose 4.7 percent, compared with a 4.4 percent drop a year earlier due to better harvests. Global food-price inflation is likely to persist as higher crude oil prices add to costs, the United Nations Food and Agriculture Organization said on May 12.

The bank next meets to set rates on June 23, 11 days after nationwide elections in which Prime Minister Recep Tayyip Erdogan is

seeking a third term in office. Polling companies including Pollmark and IKSara show his Justice and Development Party is likely to win the most votes.

'More Hawkish Tone'

"Prepare for a decidedly more hawkish tone from the central bank, coupled with fiscal tightening action from the government," Simon Quijano-Evans, chief economist for the region at ING Groep NV in London, wrote in an e-mailed statement. The bank's statement after its rate meeting on May 25, explaining why it left the benchmark rate and reserve requirements unchanged, "showed that they did not want to rock the boat ahead of elections."

Governor Erdem Basci on April 28 raised the bank's forecast for year-end inflation to 6.9 percent from 5.9 percent because of higher oil prices and taxes on imported textiles. Inflation is expected to accelerate in the second quarter before slowing in the third, he said.

Basci has added 10 percentage points to reserve requirements since December, aiming to reduce the amount of money banks can lend. Consumption growth is "moderating," the central bank said May 25.

Revising Targets

Turkey's current-account deficit, forecast by the government at \$39.3 billion or 5.4 percent of gross domestic product this year, reached \$60.5 billion in the 12 months through March as growth boosted demand for imports. The government says it will revise economic targets after the election.

The cost of goods leaving Turkish factories and mines rose an annual 9.6 percent in May, compared with an increase of 8.2 percent the previous month, the statistics agency said today. Producer prices rose 0.2 percent in the month.

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