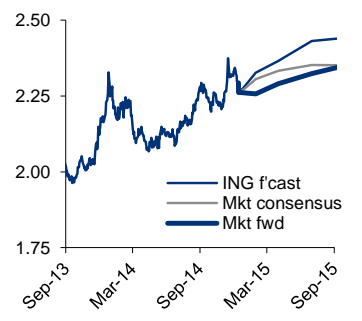


Economics

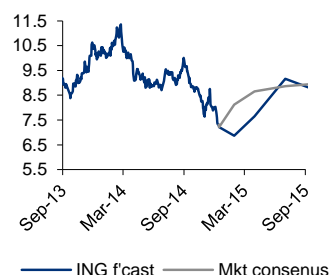
14 January 2015

USDTRY



Source: EcoWin, ING estimates

Local 10Y yields (%)



Source: EcoWin, ING estimates

US\$ Eurobond 10Y



Source: Bloomberg

Latest indicator surprises

Output	Negative
Consumption	Negative
Inflation	Lower
External	Negative
Budget	Neutral

Source: Bloomberg

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Easing on the way

Although PMI data hints at an improvement in manufacturing business conditions, a recent downside surprise in IP prints, as well as deteriorating consumer and business confidence, suggest growing downside risks to growth performance in 4Q14, although growth will be better than the mere 1.7% seen in 3Q14. December CPI data, on the other hand, provided fresh evidence of weakening inflationary pressures and continued to be impacted by general oil price weakness. This has also contributed to the improving trend in the c/a deficit that started at end-2013.

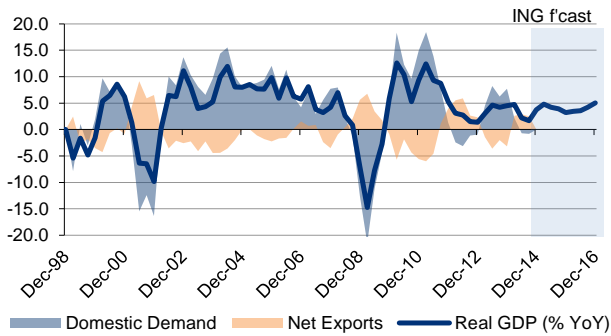
- Despite continuing weakness in oil prices, we maintain our CPI projection for 2015 at 6.4%. We note the tax hikes in alcoholic beverages and tobacco products introduced in the last week of December, as well as uncertainty in food prices. If fully reflected in prices, tax adjustments may increase CPI by as much as 0.5ppt.
- Regarding external balances, each USD10 drop in oil prices reduces the c/a deficit to c.0.5-0.6% of GDP. This should sustain the rebalancing that has continued since the beginning of last year, despite the negative impact of Russian economic developments on exports from Turkey to Russia and on tourism revenues. We see the c/a deficit narrowing from USD45bn (or 5.6% of GDP) in 2014 to USD35bn (or 4.3% of GDP) in 2015.
- The CBT has so far maintained its cautious stance and has kept money market rates elevated, reflecting recent volatility in the currency. However, the positive external environment should support the CBT in guiding money market rates lower, while a better-than-expected outlook in inflation and external balances should provide room for the CBT to ease. We now expect the bank to cut the policy rate by 75bp in 1H15, albeit with a interest rate corridor widened on the downside to keep policy flexible. The extent of the improvement in inflation, expectations about developed-market central bank actions, and the impact of economic developments in Russia should determine CBT behaviour going forward.
- The main focus over the month ahead will be on the January MPC and the release of the next inflation report.

Quarterly forecasts

	3Q14	4Q14	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F
Real GDP (%YoY)	1.7	3.8	4.8	4.2	3.9	3.2	3.4	3.6
CPI (%YoY) eop	8.9	8.2	6.6	5.3	5.5	6.4	6.3	6.3
Policy interest rate (%) eop	8.25	8.25	7.50	7.50	7.50	7.50	7.50	7.50
3-month interest rate (%) eop	10.95	10.02	7.65	9.10	8.84	8.30	8.03	7.97
10-year yield (%) eop	9.95	8.02	7.06	8.99	8.77	8.34	8.12	8.12
Exchange rate (USD/TRY) eop	2.28	2.33	2.35	2.40	2.48	2.45	2.48	2.50
Exchange rate (EUR/TRY) eop	2.88	2.82	2.75	2.76	2.78	2.70	2.68	2.63

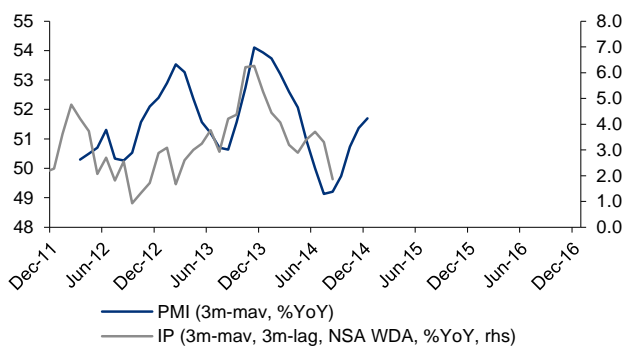
Source: EcoWin, ING estimates

Fig 1 Real GDP (%YoY) and contributions (ppt)



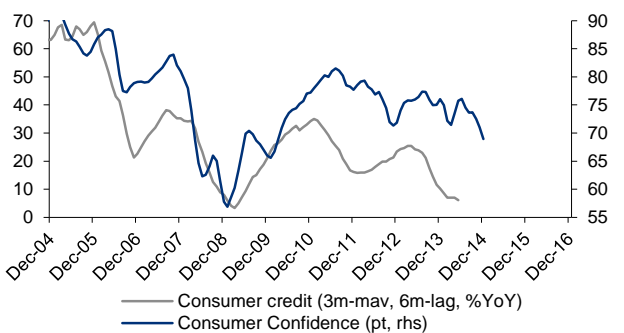
Source: EcoWin, ING estimates

Fig 2 IP vs PMI



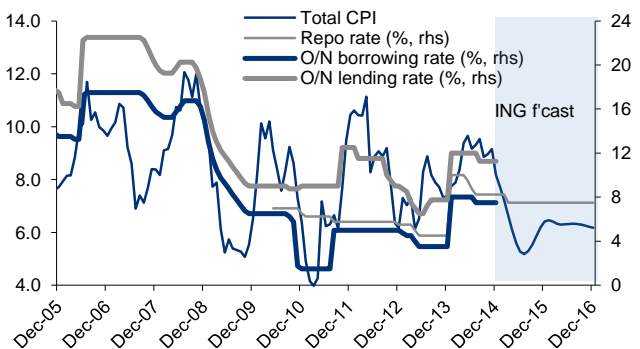
Source: EcoWin, ING estimates

Fig 3 Consumer confidence vs credit



Source: EcoWin, ING estimates

Fig 4 CPI vs policy rate



Source: EcoWin, ING estimates

Inventories pulled 3Q performance down

- GDP grew by 1.7% YoY in 3Q14, well below consensus, and pulled annualised growth down to 3.2%. The downside surprise came mainly from a large drawdown in inventories.
- Already weak private consumption slowed further, with a declining contribution to headline growth, while private investment spending improved, although it remained sluggish. Exports continued to be the main contributor to economic performance.
- Given the lack of a steady recovery in consumer and investor confidence, domestic demand painted a relatively poor picture in 3Q15 which, along with a still-strong net export contribution, shows the continuation of a more balanced growth performance.

Downside surprise in November IP

- Following a weak start to 4Q with a 2.4% YoY increase, IP recorded 0.7% YoY growth in November and turned out to be lower than 2.4% market consensus. Seasonal and calendar adjusted (SA) IP contracted by 0.15% MoM, hinting that the recovery in the industrial sector remained relatively weak in 4Q14.
- PMI improved gradually from 48.5 in July to November's nine-month high of 52.2, but eased in December to 51.4, showing the lowest growth in 4Q14, though the manufacturing upturn was sustained.
- Still-weak October and November IP prints and deteriorating consumer and business confidence in December point to growing downside risks to growth performance in 4Q14.

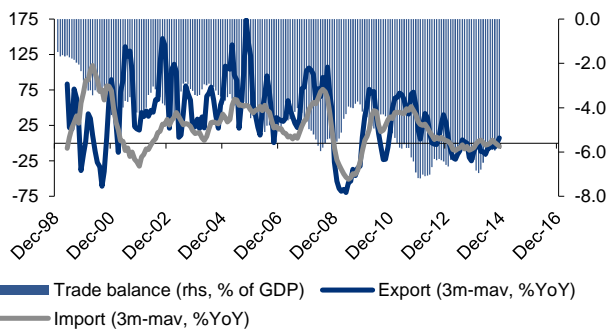
Solid loan growth expected in 2015

- Consumer confidence deteriorated in 4Q14 and in December fell to 67.7, its lowest level of the last three years. The performance is attributable to the depreciation of TRY in the last month of 2014, with fears of volatility in Russia that should exert downward pressure on already-subdued private consumption.
- The CBT is content with the slowdown in loan growth, especially in consumer lending, given regulatory pressure on that front. Macroprudential measures were introduced in 2014 to curb credit card and consumer lending growth. Given our expectation of 4% growth in 2015, the volume expansion may be in the range of 15-20% with more concentration on commercial and SME lending.

Inflation outlook improving

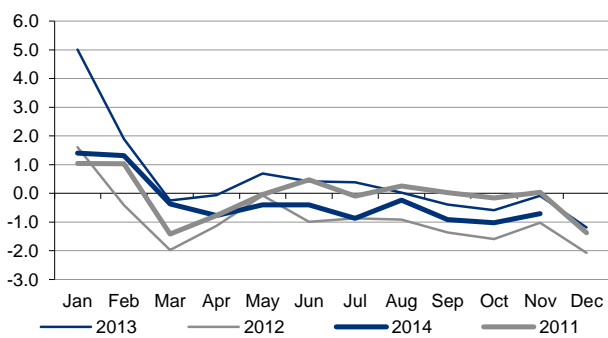
- CPI fell 0.44% last month, better than market consensus of 'no change', mainly due to the downtrend in energy prices, an unseasonably sharp drop in clothing prices and relatively benign food prices. Annual inflation improved to 8.17% from 9.15%.
- All of the nine core indicators dropped in December. In particular, annual inflation in H&I indicators declined to 9.55% and 8.73% from 9.89% and 9.03%, respectively, showing a continuation of the improvement in core indicators.
- The disinflation story should remain intact in 1H15 due to lower commodity prices, relative stabilisation in the currency, further reduced pressure from food prices and supportive base effects.

Fig 5 Trade balance (3m)



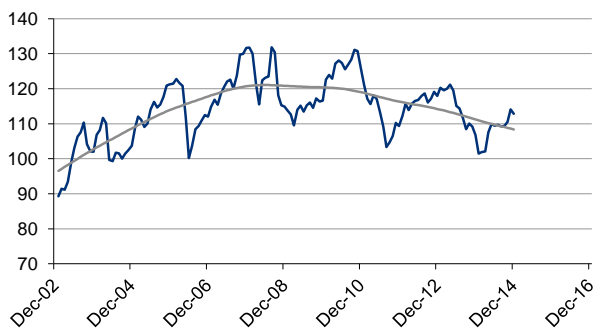
Source: EcoWin, ING estimates

Fig 6 Budget performance YTD (% GDP)



Source: EcoWin, ING estimates

Fig 7 FX: REER vs trend (index)



Source: EcoWin, ING estimates

External rebalancing to remain in place

- The foreign trade deficit came to USD8.3bn in November, pushing the annual deficit up to USD85.9bn. Exports stood at USD13.1bn, down 7.5% YoY, showing negative growth for the first time since Oct-13, while imports expanded 0.2% on a YoY basis due to a jump in the gold trade, despite supportive oil prices.
- The share of exports to the EU, which had seen an uptrend in 2014, dropped in November due to lower demand and a parity impact.
- Going forward, falling commodity prices on the back of decelerating global demand may limit import growth and contribute positively to the trade balance.

Deterioration in November budget

- The c/a budget recorded a surplus of TRY3.6bn in November vs a TRY6.4bn surplus in the same month of the previous year.
- On the revenues front, tax income remained modest at a 7.4% YoY increase. This translated into a real contraction, given that weak consumption-related tax sub-items, such as value-added tax and import tax, continued their weak performance.
- On the spending side, we see a sizable increase in primary expenditures, mainly driven by personnel expenditures and capital spending with contributions of 3.9ppt and 6.8ppt, respectively. Finally, due to the uneven distribution structure of interest payments, we see an expansion of 81% in interest expenditures

TRY vulnerable to shifts in risk appetite

- The TRY REER, which increased to 114 in November and aligned with the long-term average due to a decline in crude oil and lower than-expected CPI inflation, dropped again in December. There was growing volatility following impressive US non-farm payrolls data and contagion fears from Russian economic developments.
- The CBT maintained elevated money market rates reflecting not only the bank's commitment to FX market stability, but also the sensitivity of the currency to global market swings and consequent broad-based risk reduction across EM.
- We expect the TRY to be supported in the short-term, but pencil in some softness for 2015.

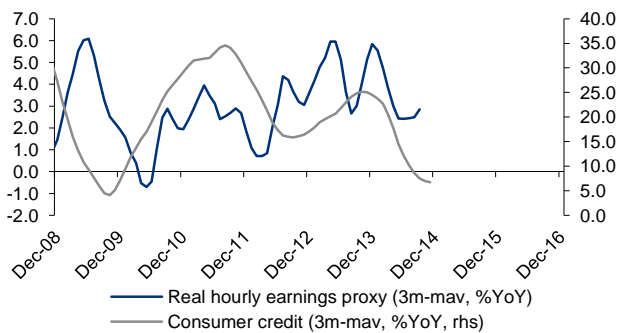
Fig 8 Main macroeconomic recent releases

		Previous -2		Previous -1		Actual	Surprise	Consensus
Capacity Utilisation (%)	Oct	74.9	Nov	74.5	Dec	74.6		-
Industrial Confidence	Oct	106.9	Nov	102.7	Dec	101.2		-
Industrial Production (SA WDA, MoM%)	Sep	2.2	Oct	-1.8	Nov	-0.2	-	1.3
Industrial Production (WDA, YoY%)	Sep	2.5	Oct	2.4	Nov	0.7	-	1.8
Turkey Consumer Confidence	Oct	70.3	Nov	68.7	Dec	67.7		-
Unemployment Rate (%)	Jul	9.8	Aug	10.1	Sep	10.5	+	10.2
GDP (SA WDA, QoQ%)	Q1	1.8	Q2	-0.5	Q3	0.4	+	0.4
GDP (YoY%)	Q1	4.8	Q2	2.2	Q3	1.7	-	2.8
GDP (WDA, YoY%)	Q1	4.8	Q2	2.5	Q3	1.8	-	2.8
Turkey core CPI (YoY%)	Oct	9.0	Nov	9.0	Dec	8.7	-	9.0
CPI (YoY%)	Oct	9.0	Nov	9.2	Dec	8.2	-	8.8
PPI (YoY%)	Oct	6.8	Nov	5.7	Dec	7.0		-
1W Repo Rate Announcement (%)	Oct	8.25	Nov	8.25	Dec	8.25		8.25
Overnight Borrowing Rate Announcement (%)	Oct	7.50	Nov	7.50	Dec	7.50		7.50
Overnight Lending Rate Announcement (%)	Oct	11.25	Nov	11.25	Dec	11.25		11.25
Trade Balance (\$bn)	Sep	-6.9	Oct	-6.3	Nov	-8.3	-	-7.0
Current Account (\$bn)	Sep	-2.3	Oct	-2.0	Nov	-5.6	-	-5.4

Source: Bloomberg

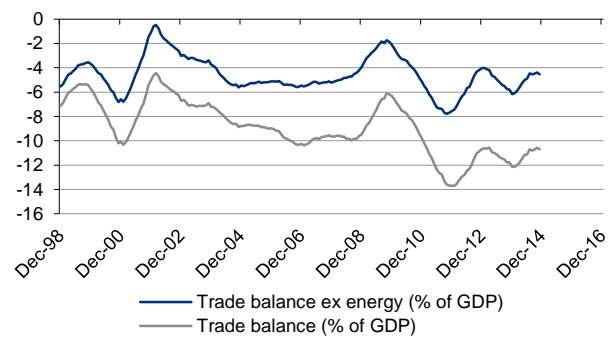
Additional charts

Fig 9 Wages and credit



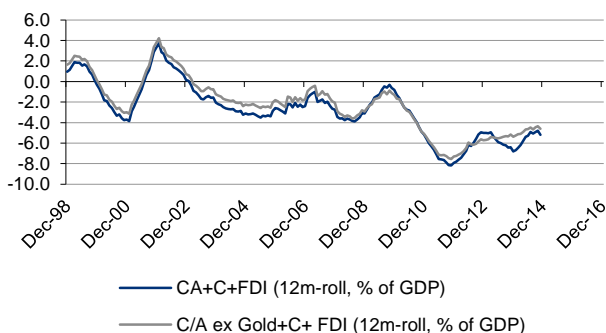
Source: EcoWin, ING estimates

Fig 10 Trade balance (annual)



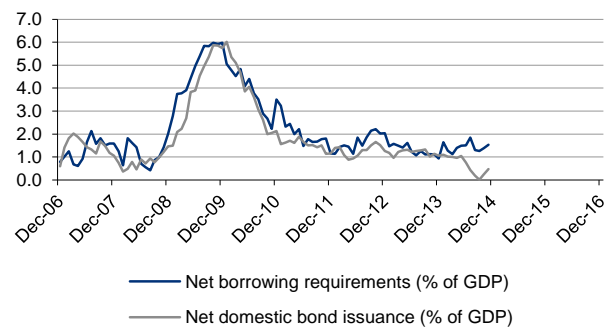
Source: EcoWin, ING estimates

Fig 11 C/A, CA and FDI



Source: EcoWin, ING estimates

Fig 12 Gvt' central borrowing requirements (annual)



Source: EcoWin, ING estimates

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