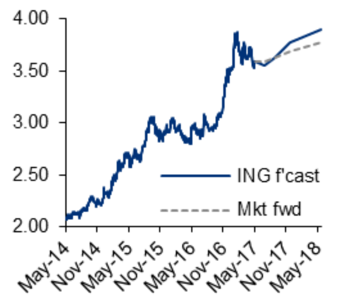
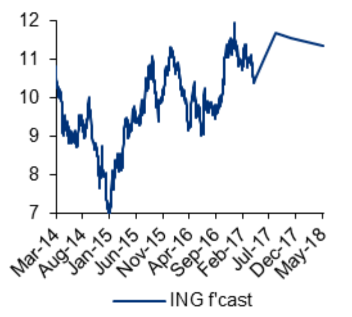
Emerging Markets
9 May 2017

USD/TRY



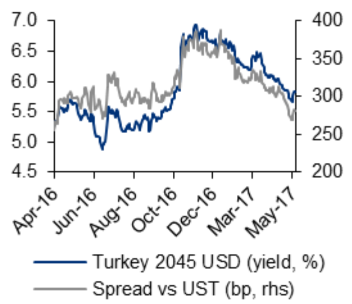
Source: Reuters, ING estimates

Local 10Y yields



Source: Reuters, ING estimates

US$ Eurobond 30Y



Source: Reuters

Latest indicator surprises

Output	Positive
Consumption	Positive
Inflation	Higher
External	Neutral
Budget	Negative

Source: Bloomberg

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MonitorING Turkey

Reduced political uncertainty…

The focus in domestic politics has shifted to the possibility of changes in the cabinet, the adjustment process in legal infrastructure to the executive presidency and early election risk, though both President and PM reiterated that elections would be held on time. Reduced uncertainty following the referendum outcome has been a relief for the markets though political issues are still likely to prevail.

- We revise our real GDP growth forecast up from 3.1% to 3.7% for 2017 on the back of not only the reduced political uncertainty following the April referendum, but also ongoing supportive fiscal policy and the impact of policy measures introduced on the credit front. Accordingly, strong credit expansion with the support of the Credit Guarantee Fund and a better contribution from net exports are expected to help the rebound in growth again while base effects will also turn positive in 2H, though higher interest rates with ongoing tightening in the monetary policy will weigh on investment and consumption in the coming period and limit recovery in the activity.
- In recent months, rising oil prices have weighed on external balances despite strong recovery in the export performance. We now see the deficit reaching USD36bn this year translating into 4.3% of GDP, given less supportive energy prices, a likely mean-reversion to a structural deficit in the gold balance as well as higher-than-expected recovery prospects in the activity, while these factors are partially offset by price competitiveness from the TRY slide and export demand from the EU. It should be noted that differing from our view the CBT sees improvement in external deficit this year with robust goods export growth.

FX and Money Markets: In the inflation report release, the CBT hinted it would refrain from early easing and maintain the tight stance until a significant improvement in the inflation outlook became apparent. Not only the tight policy, but also carry friendly global backdrop, cheap TRY valuation, and better flow outlook after the referendum will continue to support the currency in the near term.

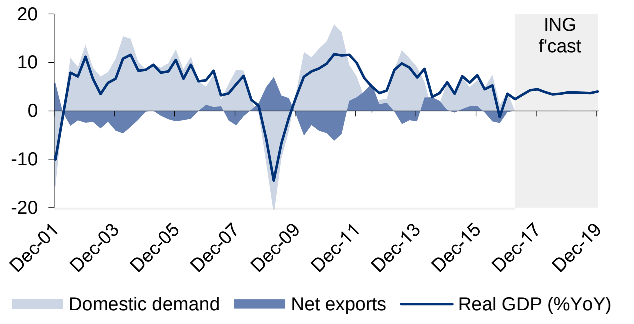
Domestic Debt and Rates: Since mid-February, inflows to the domestic bond market have accelerated with the tightening in monetary policy as well as a conducive external backdrop, amounting to USD1.8bn ahead of the April referendum, while another USD0.8bn was recorded in the second half of April due to reduced political uncertainty with more than 50bp drop in the long-end of the yield curve. Short end is to remain elevated in the coming period given the CBT's ongoing hawkish rhetoric.

Quarterly forecasts

	4Q16	1Q17	2Q17F	3Q17F	4Q17F	1Q18F	2Q18F	3Q18F
Real GDP (%YoY)	3.5	2.4	3.3	4.2	4.4	3.9	3.4	3.5
CPI (eop, %YoY)	8.5	11.29	11.2	11.1	9.5	7.6	7.5	7.8
Central bank key rate (eop, %)	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
3m interest rate (eop, %)	9.90	12.12	10.87	11.52	10.70	10.22	10.87	10.38
10yr yield (eop, %)	11.39	10.93	11.01	11.84	11.25	10.84	11.48	11.00
USD/TRY exchange rate (eop)	3.53	3.63	3.55	3.69	3.80	3.86	3.93	3.99
EUR/TRY exchange rate (eop)	3.70	3.92	3.98	4.24	4.37	4.44	4.71	4.83

Source: ING estimates

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

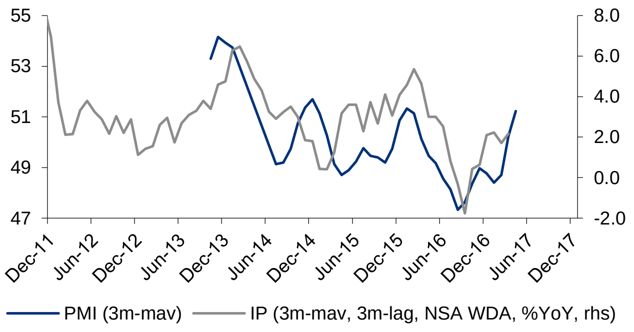


Source: TurkStat, ING estimates

Growth is likely to accelerate this year

- Economic activity saw a rebound in 4Q16 with a sharp recovery in private consumption and net exports. Although there are some signals of moderation in 1Q17 ahead of the referendum, the ongoing supportive fiscal stance and recently bolstered Credit Guarantee Fund along with improvement in domestic conditions after the referendum show that growth is to strengthen from 2Q.
- In other words, given that the ongoing positive credit impulse with easing macro prudential measures and accommodative government incentives, growth is to gain momentum vs a modest 2.9% in 2016. Net exports that were a drag in previous quarters are likely to support activity this year.

Fig 2 IP vs PMI

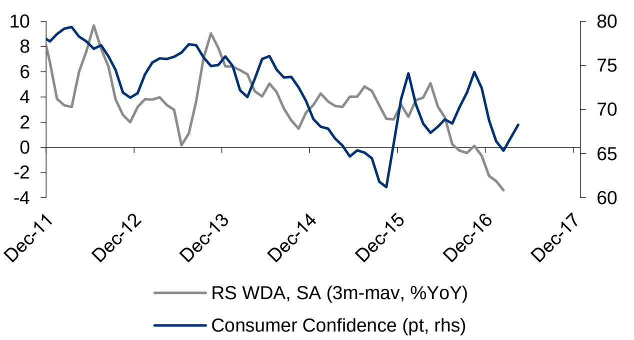


Source: Markit, TurkStat, ING estimates

Sequential quarterly IP growth moderated in 1Q

- Following a relatively weak reading in February, the seasonal and calendar adjusted (SA) IP index recorded 1.26% expansion in the third month of the year, showing continuation of recovery.
- The sequential IP (SA) growth in 1Q stood at +1.4%, a momentum loss from 4.2% in 4Q, but all broad economic categories have remained in positive territory. Durable consumer goods stood out, in particular, with a 9.8% QoQ change, a strong performance in 1Q supported by the VAT cut on certain consumer durables, while energy recorded 3.6% QoQ growth rate. These were the two groups with accelerating activity over the previous quarter while the rest showed some weakening in sequential terms.

Fig 3 Retail sales vs consumer confidence

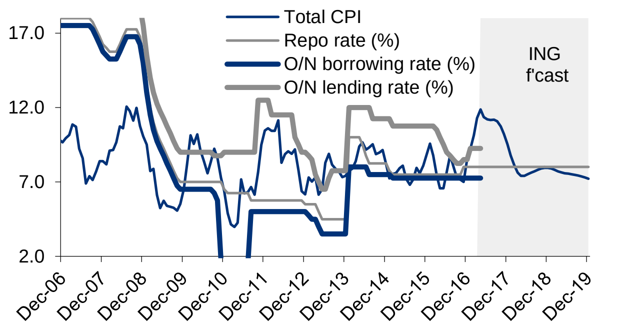


Source: TurkStat, ING estimates

The unemployment rate recovered in January

- The unadjusted unemployment rate in Jan-17 recorded a marked increase to 13.0% from 11.1% a year ago.
- The pressure in the labour market shows signs of easing, following gradual recovery in the activity as well as measures taken by the government and President Erdogan's call for a hiring mobilization to curb the unemployment. According to Labour Minister, more than 407K new jobs were created in 1Q017 vs the 2m target set by the President in February. Going forward, subpar growth performance is likely to weigh on the employment, though government incentives and promises by some private entities after the hiring mobilization have potential to change the picture.

Fig 4 CPI vs policy rate

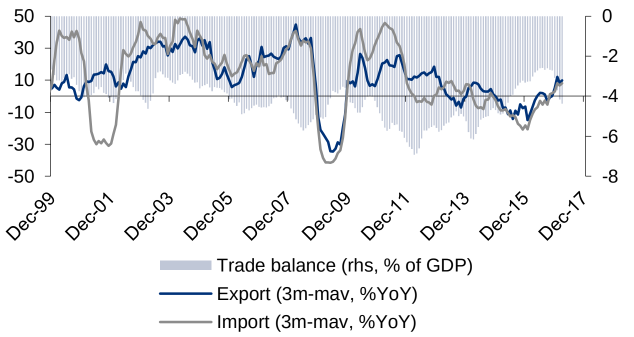


Source: CBT, ING estimates

Headline core inflation in line with consensus

- CPI at 1.31% MoM was in line with the consensus, though higher than our call at 1.1%. The figure pulled annual inflation up further to 11.9%, the highest since Oct-08, from 11.3% a month ago. This is attributable to volatile food prices and clothing as well as negative base effects from last year.
- The outlook has deteriorated recently with the lagged spillovers of TRY depreciation and volatility in food prices. We think that April inflation is likely to mark a peak in the uptrend and will not make any significant impact on CBT behaviour following significant tightening in liquidity conditions and consequent adjustment in the effective cost of funding to 11.8% from 8.3% in January.

Fig 5 Trade balance (3m, % of GDP)

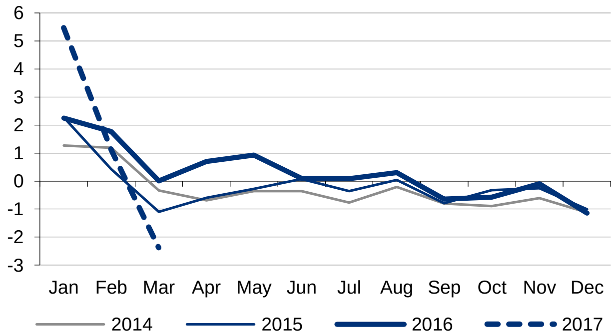


Source: TurkStat, ING estimates

Modest narrowing in 12M rolling trade deficit

- The foreign trade deficit, at USD4.5bn in March pulled the annual deficit down to USD56.5bn. Following a marginal growth in imports, by 1.6% YoY in February, we saw a 6.9% YoY change in March, while exports, maintaining the relatively strong pace of recent months, jumped by 13.6% YoY, translating into a 10% contraction of the trade deficit vs the same month of 2016.
- Coverage of imports by exports on a 12M rolling basis rose to 72.1%, the highest since end-2009. The data show the impact of the recovery in the core trade deficit (excluding gold and energy), despite deterioration in the energy deficit in the same period, reflecting impact of oil prices and less supportive net gold trade.

Fig 6 Budget performance YTD (% of GDP)

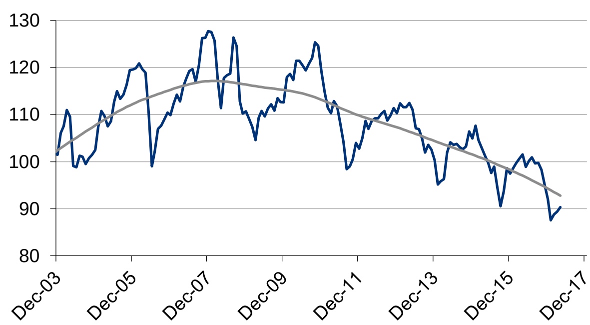


Source: Ministry of Finance, ING estimates

Further weakness in March budget

- Following a strong performance in January due to the transfer of TRY4.2bn in the privatization fund from the last year to the budget accounts and supportive impact of receipts from the tax amnesty, fiscal performance in February and March witnessed deterioration.
- In March alone, the budget balance recorded a TRY19.5bn deficit, almost tripled over the same month of 2016 with a TRY-6.6bn reading. The monthly outcome shows weakness in revenue generation (a contraction by 3.0% YoY) and elevated primary spending at 28.2% YoY growth, though interest expenditures remained modest with 6.3% YoY. The primary balance also turned to deficit at TRY12.4bn, from TRY0.2bn surplus.

Fig 7 FX: REER vs trend (index, ppt)



Source: CBT, ING estimates

The CBT delivered further LLW tightening

- In the April rate-setting meeting, the CBT hiked the late liquidity window (LLW) rate by 50bp to 12.25%.
- In the April statement, the hawkish tone a month ago seems to have eased as the bank mentions that “the recent improvement in the risk appetite contains some of the upside pressures from cost factors” while it is widely expected that April inflation is likely to mark a peak in the recent uptrend. However, the CBT remains on alert given “risks on the pricing behaviour” with the current high level of inflation. So, it signals more tightening, depending on the evolution of prices and to “use all available instruments in pursuit of the price stability objective”.

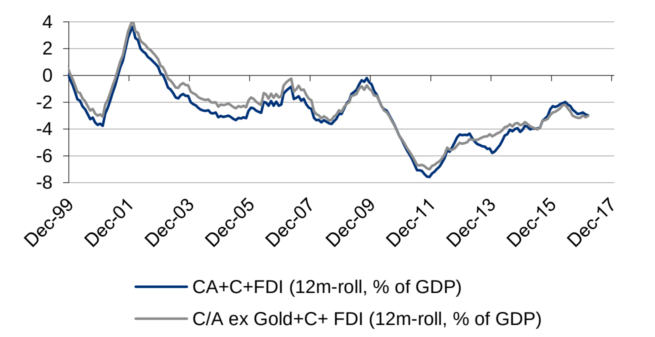
Fig 8 Main macroeconomic recent releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilization (%)	Feb	76.8	Mar	76.7	Apr	78.4	+	75.2
Industrial Confidence	Feb	105.9	Mar	108.9	Apr	111.2	+	109
Industrial Production (SA WDA, MoM%)	Jan	1.3	Feb	-0.4	Mar	1.3	+	0.8
Industrial Production (WDA, YoY%)	Jan	2.6	Feb	1.0	Mar	2.8	+	2.5
Consumer Confidence	Feb	65.7	Mar	67.8	Apr	71.3	+	65
Unemployment Rate (%)	Nov	12.1	Dec	12.7	Jan	13.0		13
GDP (SA WDA, QoQ%)	Q2	5.3	Q3	-1.3	Q4	3.5		
GDP (YoY%)	Q2	5.4	Q3	-1.3	Q4	3.4	-	3.7
Core CPI (YoY%)C	Feb	8.6	Mar	9.5	Apr	9.4	-	9.9
CPI (YoY%)	Feb	10.1	Mar	11.3	Apr	11.9	+	11.7
PPI (YoY%)	Feb	15.4	Mar	16.1	Apr	16.4	+	15.9
1W Repo Rate Announcement (%)	Jan	8.00	Mar	8.00	Apr	8.00		8.00
Overnight Borrowing Rate Announcement (%)	Jan	7.25	Mar	7.25	Apr	7.25		7.25
Overnight Lending Rate Announcement (%)	Jan	9.25	Mar	9.25	Apr	9.25		9.25
Trade Balance ($bn)	Jan	-4.3	Feb	-3.7	Mar	-4.5	+	-4.5
Current Account ($bn)	Dec	-4.3	Jan	-2.8	Feb	-2.5	-	-2.5

Source: Bloomberg

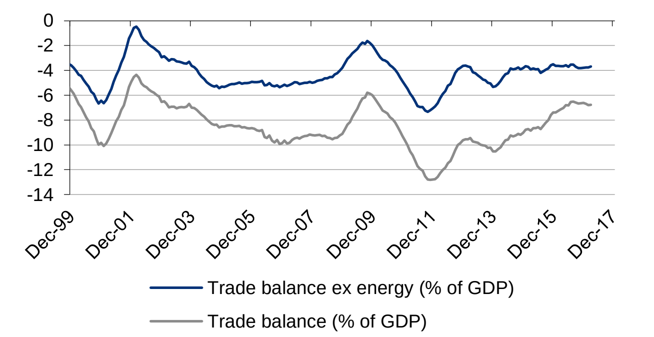
Additional charts

Fig 9 C/A (annual; % of GDP)



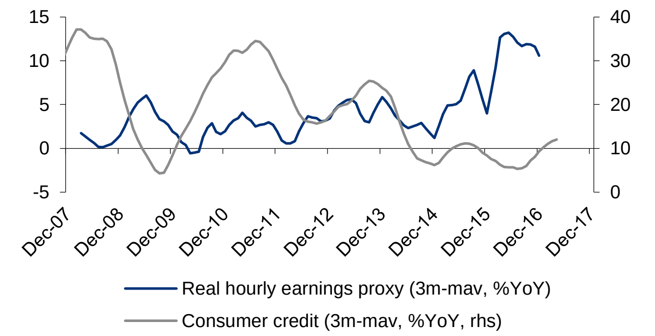
Source: CBT, ING estimates

Fig 10 Trade balance (annual; % of GDP)



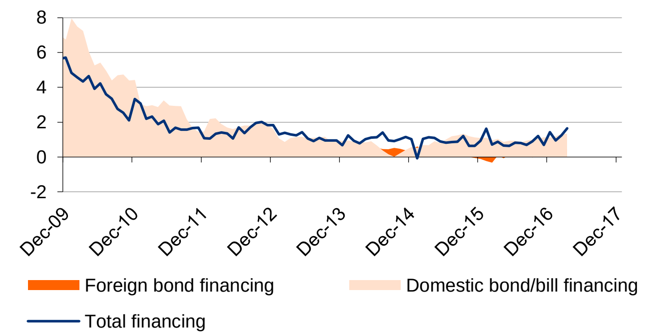
Source: TurkStat, ING estimates

Fig 11 Real wages growth (%)



Source: TurkStat, BRSA, ING estimates

Fig 12 Central govt borrowing (annual; % of GDP)



Source: Treasury, ING estimates

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