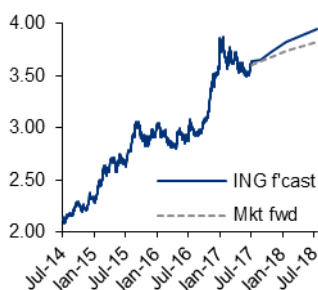


Emerging Markets

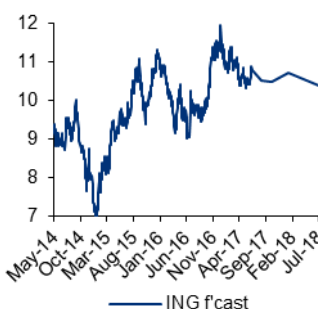
11 July 2017

USD/TRY



Source: Reuters, ING estimates

Local 10Y yields



Source: Reuters, ING estimates

US\$ Eurobond 30Y



Source: Reuters

Latest indicator surprises

Output	Negative
Consumption	Positive
Inflation	Lower
External	Neutral
Budget	Positive

Source: Bloomberg

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# MonitorING Turkey

## CBT to remain cautious

Price pressures have started weakening with the TRY stabilisation in recent months, while the downtrend in annual inflation is likely to continue in July and fall below 10% on supportive base effects and the government’s decision to stay the tax hike on tobacco prices and cut import taxes on some food products. Our inflation forecast for this year stands at 9.4%, but risks seem to be skewed to the downside.

- Given this backdrop, we expect the CBT to maintain its cautious rhetoric and not ease the average funding cost in the near term, as annual inflation is likely to return to double-digit territory once again after July on negative base effects and remain elevated before falling consistently to single digits at year-end. The recent hawkish twist in the policy stance of global central banks, which has the potential to hurt TRY stability, is also likely to add to CBT concerns on likely repercussions of an early easing.
- After economic growth rebounded to positive territory in the last quarter of 2016, following political tensions and a shock to the tourism sector, we saw across-the-board strength, with further recovery in private consumption and net exports in 1Q17. Recently released indicators hint at some further acceleration in activity, with higher PMI in tandem with rising CUR. Improvement in sectoral and consumer confidence after the referendum should also contribute to the recovery. Accordingly, we raise our growth forecast for 2017 from +3.7% to +4.4%, while risks seem to be toward the upside, given the buoyant activity in 2Q17 and low base effects of 3Q16.

The release of the third inflation report for the year on 1 Aug is due to provide more clues on how the CBT sees the inflation outlook, while the July MPC could show how the CBT is responding to the weakening price pressures, as evidenced by the inflation release.

**FX and money markets:** Following the sharp upward move in developed market government bond yields, EM assets witnessed some pressure, while TRY, in particular, has depreciated close to 3% versus the USD and more than 5% versus the EUR over the last two weeks. Given TRY’s strong sensitivity to fluctuations in risk appetite, staying defensive until the pace of movement in rates slows would be better, despite the recent inflation surprise to the downside and the CBT’s ongoing tightening stance.

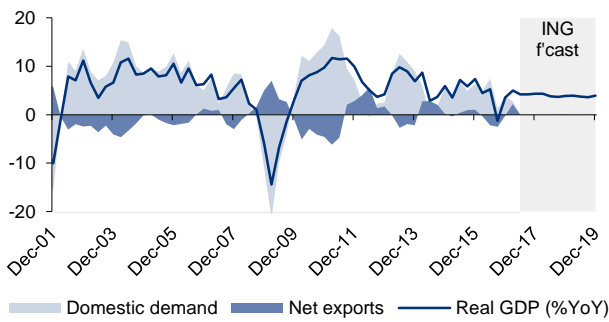
**Domestic debt and rates:** Debt inflows have been robust in the first half of 2017, amounting to USD4.5bn (including repos), while we see acceleration especially after the referendum on an improving domestic climate. Local rates experienced a spell of pressure on a sharp move higher in developed market yields, as 10Y local bond rates rose by c.50bp. We expect 10Y yields to remain sensitive to global volatility.

Quarterly forecasts

	1Q17	2Q17	3Q17F	4Q17F	1Q18F	2Q18F	3Q18F	4Q18F
Real GDP (%YoY)	5.0	4.2	4.2	4.3	4.3	3.8	3.7	3.9
CPI (eop, %YoY)	11.3	10.90	10.8	9.4	7.5	7.7	8.0	7.9
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, %)	12.12	12.71	11.85	11.35	11.29	11.09	10.70	10.86
10yr yield (eop, %)	10.93	10.53	10.43	10.70	10.67	10.51	10.16	10.32
USD/TRY exchange rate (eop)	3.63	3.52	3.68	3.80	3.86	3.93	3.99	4.05
EUR/TRY exchange rate (eop)	3.92	3.94	4.23	4.37	4.44	4.71	4.79	4.86

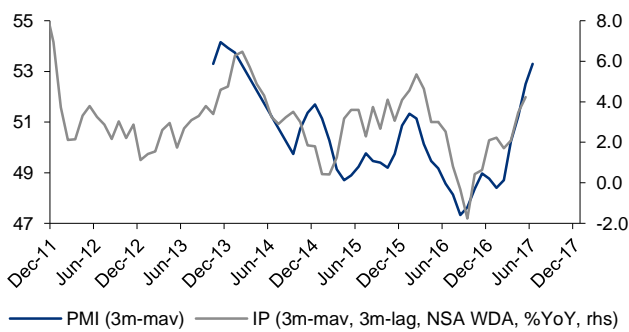
Source: ING estimates

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



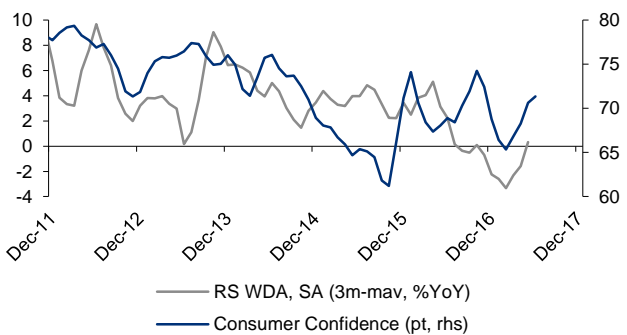
Source: TurkStat, ING estimates

**Fig 2 IP vs PMI**



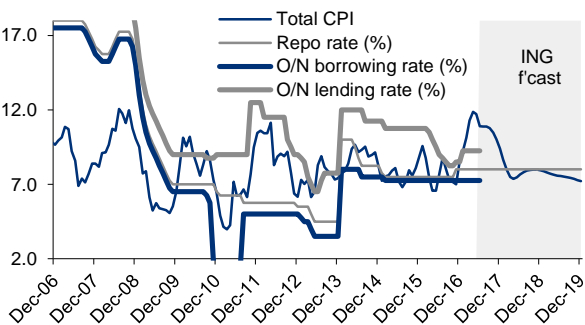
Source: Markit, TurkStat, ING estimates

**Fig 3 Retail sales vs consumer confidence**



Source: TurkStat, ING estimates

**Fig 4 CPI vs policy rate**



Source: CBT, ING estimates

**Significant upside surprise in 1Q17 growth**

- Economic activity was higher than expected in 1Q17, with 5.0% YoY growth, while market expectations were at c.3.5% in a range of 0.8-4.8%, vs our call at 3.6%. Accordingly, following a contraction in 3Q16 for the first time since the global crisis, growth has maintained an improving trend, pulling annual GDP growth to 3.0% in the last quarter, from 2.9% in 2016.
- In the breakdown of the GDP print on the expenditure side, the biggest contributions came from private consumption (+3.1ppt), government consumption (+1.3ppt) and net exports (+2.2ppt), while investments turned out to be sluggish again, though remaining in positive territory with +0.6ppt.

**Lower-than-expected IP in May**

- The industrial production index (calendar-adjusted) was below market consensus at 4.3%, with a modest 3.47% YoY increase in May. On the other hand, following a strong 2.20% reading in April, the seasonal and calendar adjusted (SA) IP index witnessed a 1.46% contraction in the fifth month of the year. However, the performance in the two months of 2Q17 shows some acceleration over the 1.4% QoQ growth recorded in 1Q17.
- Overall, despite a weaker reading in May, the IP in 2Q17 hints that the recovery that started in the last quarter of 2016 is continuing, driven by policy measures such as macro-prudential easing and a supportive fiscal stance, along with supportive external demand.

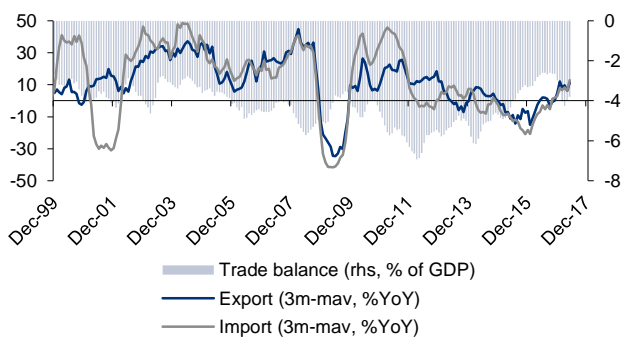
**The unemployment rate improved further in Mar-17**

- The unadjusted unemployment rate in Mar-17 recorded a marked rise to 11.7%, from 10.1% a year ago. On the flipside, despite a further increase in participation to an all-time high at 52.7% in March, the seasonally adjusted figure maintained the recovery that began in the beginning of this year with another drop from 11.7% to 11.5%, with significant employment generation.
- On a sequential basis, job creation was at 115K MoM in the third month of 2017, driven by industry (95K), construction (61K) and services (64K), while agriculture recorded a loss at -105K. The breakdown of labour data reveals that the youth unemployment rate (SA) was also down at 21.9%, from 22.1% a month ago.

**Sharp fall in June annual inflation**

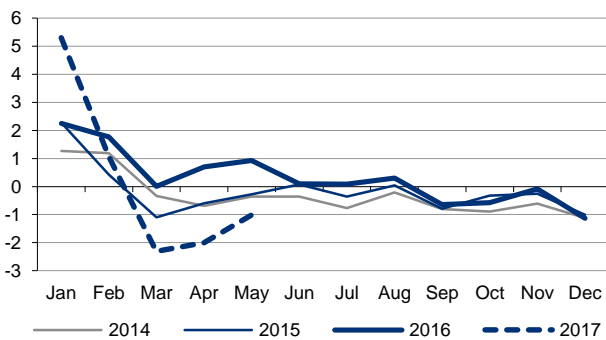
- June witnessed a negative inflation print at -0.27% MoM, due to a correction in food prices and lower energy prices, along with stability in the currency. Accordingly, annual inflation maintained a downtrend, with a sharper-than-expected drop to 10.90%, from 11.72% a month ago. Core inflation was also benign in June, with a mere 0.1% MoM change due to the fading FX pass-through, though remaining elevated at above 9%.
- The downtrend in annual inflation is likely to continue in July and fall below 10% on supportive base effects and the government's decision to stay the tax hike on tobacco prices and cut the import tax on some food products.

**Fig 5 Trade balance (3m; % of GDP)**



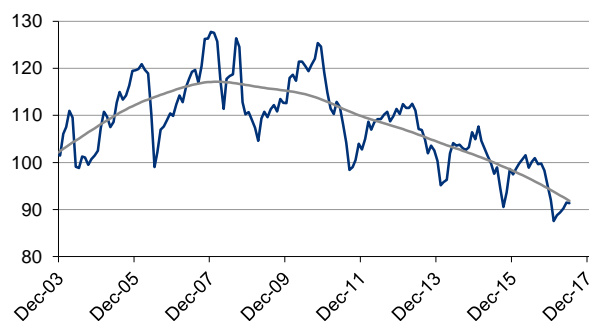
Source: TurkStat, ING estimates

**Fig 6 Budget performance YTD (% of GDP)**



Source: Ministry of Finance, ING estimates

**Fig 7 FX: REER vs trend (index; ppt)**



Source: CBT, ING estimates

**Strength in May imports**

- The foreign trade deficit, at USD7.3bn in May, pulled the annual deficit out of its range (of USD56-57bn, after reaching its lowest level since mid-2010 last August) with a marked expansion, now standing at USD59.5bn.
- Following a positive reading in imports at 9.9% YoY in April, we saw a 21.7% jump on a YoY basis (+9.0% on a sequential basis) in May, thanks to more-than-tripled gold imports and a marked increase in oil imports. On the other hand, exports, maintaining its recovery in recent months, rose by 12.5% YoY (albeit being a 0.2% MoM contraction) and translating into a 43.3% expansion of the merchandise trade deficit vs the same month of the previous year.

**Strong May budget, but fiscal pressure remains**

- Pressure on the fiscal side has continued due to government efforts to provide a lift to growth via economic incentive packages, increases in investment spending and reduced dividend payments, along with the transfer of some state-owned companies to the coverage of the extra budgetary sovereign wealth fund.
- In May alone, the central administration budget balance recorded a TRY6.4bn surplus, vs TRY3.7bn in the same month of last year. The monthly outcome shows strength in revenue generation (16.1% YoY) and a sharp 27.3% YoY drop in interest expenses due to the Treasury's uneven repayment schedule, despite continuing momentum in primary expenditure, with a 16.2% YoY rise.

**As expected, no change at June MPC meeting**

- At its June meeting, the CBT remained mute, in line with consensus. The MPC decision marks an end to the tightening cycle, given that inflation has already peaked in April, while easing domestic political concerns after the referendum and a supportive flow outlook for EMs provided relief for the CBT.
- In recent statements, the CBT has sounded quite hawkish, while in the June statement, it seemed to tone down a little, acknowledging the recent peak in the inflation outlook and seeing further disinflation ahead. However, the central bank remains on alert, reiterating its key policy guidance that the monetary policy will stay tight until there is significant improvement in inflation dynamics.

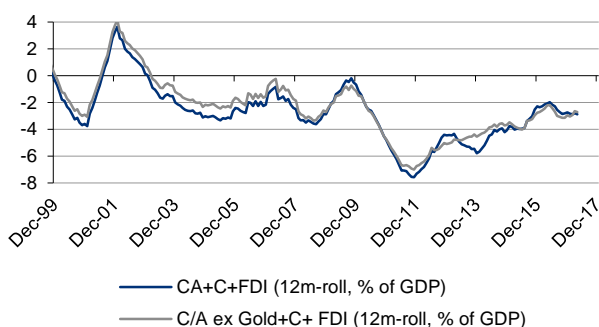
**Fig 8 Main recent macroeconomic releases**

Indicator		Previous -2		Previous -1		Actual	Surprise	Consensus
Capacity Utilisation (%)	Apr	78.4	May	78.8	Jun	79	-	-
Industrial Confidence	Apr	111.2	May	109.2	Jun	112.4	-	-
Industrial Production (SA WDA; MoM%)	Mar	1.1	Apr	2.2	May	-1.5	-	-0.2
Industrial Production (WDA; YoY%)	Mar	2.6	Apr	6.7	May	3.5	-	5.0
Consumer Confidence	Apr	71.3	May	72.8	Jun	70.0	-	-
Unemployment Rate (%)	Jan	13.0	Feb	12.6	Mar	11.7	-	11.95
GDP (YoY%)	3Q	-1.3	4Q	3.5	1Q	5.0	+	3.7
GDP (WDA; YoY%)	3Q	-0.9	4Q	3.3	1Q	5.2	+	3.9
Core CPI (YoY%)	Apr	9.4	May	9.4	Jun	9.2	-	9.5
CPI (YoY%)	Apr	11.9	May	11.7	Jun	10.9	-	11.2
PPI (YoY%)	Apr	16.4	May	15.3	Jun	14.9	-	14.6
1W Repo Rate Announcement (%)	Mar	8.00	Apr	8.00	Jun	8.00		8.00
Overnight Borrowing Rate Announcement (%)	Mar	7.25	Apr	7.25	Jun	7.25		7.25
Overnight Lending Rate Announcement (%)	Mar	9.25	Apr	9.25	Jun	9.25		9.25
Trade Balance (US\$bn)	Mar	-4.5	Apr	-4.9	May	-7.3	-	-7.7
Current Account (US\$bn)	Feb	-2.4	Mar	-3.0	Apr	-3.6	-	-3.6

Source: Bloomberg

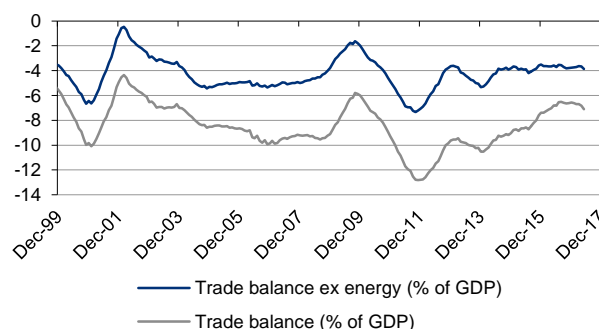
### Additional charts

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



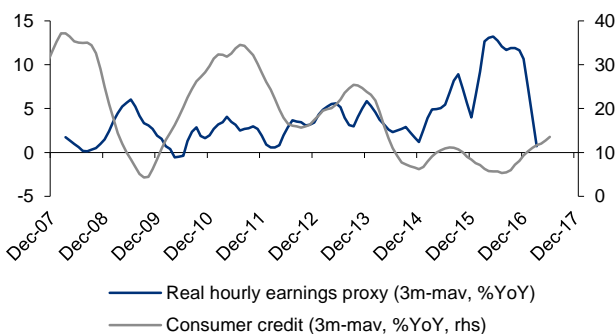
Source: CBT, ING estimates

**Fig 10 Trade balance (annual; % of GDP)**



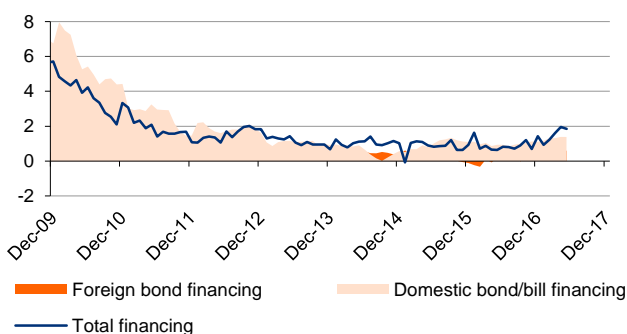
Source: TurkStat, ING estimates

**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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