

Economics

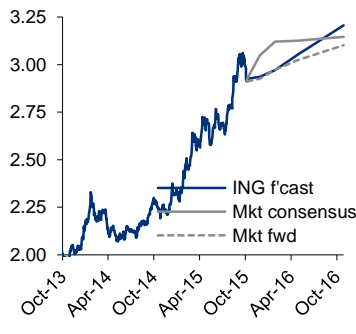
13 October 2015

# MonitorING Turkey

## Another hung parliament?

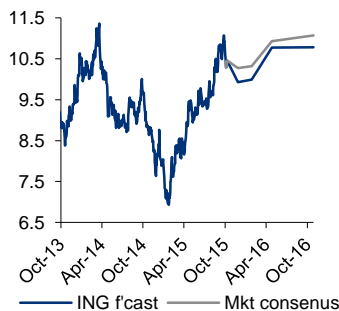
Following the collapse of coalition talks, a new ballot will be held on 1 November. Changing the constitution to support an expanded presidential role was at the centre of the June election campaign and is likely to remain so in the upcoming elections. The war in Syria and rising geopolitical risks weighing on domestic security are likely to be other major campaign issues. Latest polls show a range of results and another hung parliament is a possibility. HDP's strength is a crucial issue; if it meets the 10% electoral threshold, it stands to dilute the number of parliamentary seats for the other main parties, including the AKP. Political uncertainty might linger into 2016, threatening further political instability, with a consequent negative impact on macro indicators.

### USD/TRY



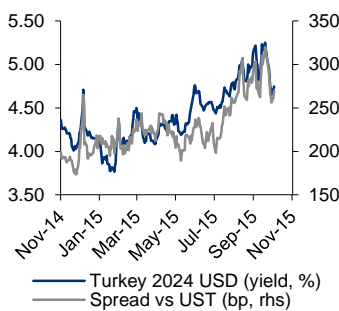
Source: Macrobond, ING estimates

### Local 10Y yields



Source: Macrobond, ING estimates

### US\$ Eurobond 10Y



Source: Bloomberg, Reuters

### Latest indicator surprises

Output	Positive
Consumption	Negative
Inflation	Higher
External	Positive
Budget	Neutral

Source: Bloomberg

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### Key points:

- Following an upside surprise in inflation and higher-than-expected TRY weakness, we revise up our end-2015 CPI inflation forecast from 7.9% to 8.1%. Given worsening expectations and the likely impact on general pricing behaviour, we also revise the end-2016 forecast from 6.8% to 7.2%.
- In its simplification process, the CBT envisages making the 1-week rate the sole policy rate, while market conditions – also a function of the Fed's actions – will determine the pace and extent of adjustment, currently expected to be gradual. The timing of the monetary adjustment is still uncertain, but we forecast the 1-week repo rate at 9.5% in 2016 and pencil in a further 150bp of hikes in 2017, to reach 11%.

### Strategy:

**FX:** Markets have become more bullish since the beginning of October, with expectations of a delay in Fed tightening, despite growth prospects remaining gloomy. In this environment, the TRY has appreciated along with its EM peers, by more than 3%, while the 50:50 USD:EUR basket fell into the 3.11-3.12 range, from c.3.25 at end-September. We expect political and geopolitical risks to limit TRY recovery.

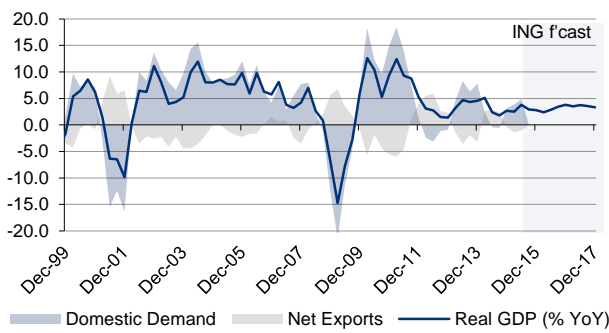
**Local debt:** Benchmark yields have been under pressure since the beginning of 2015 on the back of elevated inflation, a deteriorating growth outlook and political uncertainty, along with weaker investment sentiment on EM countries, driven by Fed concerns and increasingly sluggish global growth prospects. Recently, we have seen a drop in rates as markets price in low US rates for longer. However, given Turkey's ongoing idiosyncratic risks, we think that a recovery in yields might be short-lived.

### Quarterly forecasts

	2Q15	3Q15	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F
Real GDP (%YoY)	3.8	2.9	2.8	2.4	2.9	3.4	3.8	3.5
CPI (%YoY) eop	7.2	7.9	8.1	7.1	6.9	6.7	7.2	7.0
Policy interest rate (%) eop	7.50	7.50	8.00	8.50	9.00	9.00	9.50	10.00
3-month interest rate (%) eop	11.34	12.18	11.11	11.01	11.00	11.00	11.00	11.00
10-year yield (%) eop	9.36	11.03	9.84	10.56	10.92	10.80	10.90	11.43
Exchange rate (USDTRY) eop	2.68	3.03	2.95	3.03	3.10	3.18	3.25	3.31
Exchange rate (EURTRY) eop	2.99	3.38	3.10	3.09	3.04	3.18	3.32	3.45

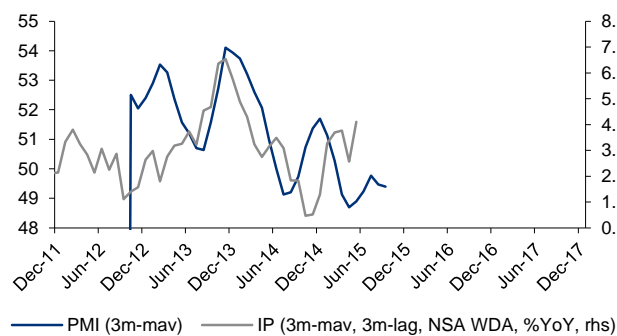
Source: Macrobond, ING estimates

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



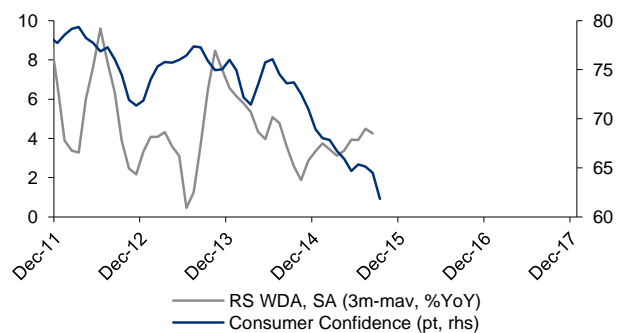
Source: Macrobond, ING estimates

**Fig 2 IP vs PMI**



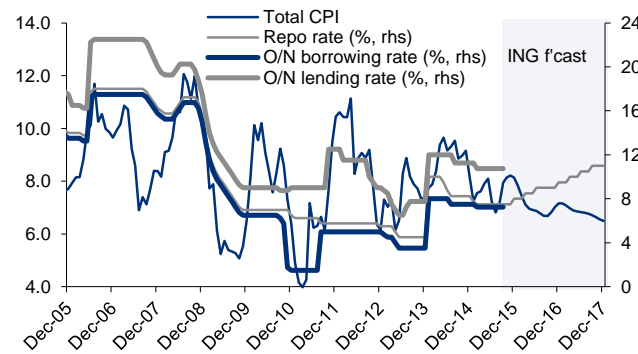
Source: Macrobond, ING estimates

**Fig 3 Retail sales vs consumer confidence**



Source: Macrobond, ING estimates

**Fig 4 CPI vs policy rate**



Source: Macrobond, ING estimates

**Growth risks tilted to the downside**

- Domestic demand became the main driver of GDP growth in 2Q15, with some support from public demand, while net exports and inventories weighed on growth.
- Given the repeat election in November, political uncertainty will continue to dominate for at least the rest of the year. In this environment, downside risks to the growth outlook are increasing, contributed to by volatile and weak capital flows as well as ongoing geopolitical risks, with an absence of any meaningful improvement in key export markets. These have already pushed up lending rates, with a significant deceleration in volume expansion. We expect 3.0% and 3.1% growth for 2015 and 2016.

**Upside surprise in August IP**

- The industrial production index (calendar adjusted), which posted a weak, below-consensus print in July, jumped by a significant 7.2% YoY increase in August, the highest move since Jan-14, vs 1.5% market consensus. The seasonal and calendar adjusted (SA) IP index that generally tracks a volatile path came in at 2.9% on a sequential basis, up from -1.5% a month ago, showing a strong recovery after a weak start to 3Q.
- Overall, August IP turned out far better than consensus expectations, following a weak start to 3Q, even though PMI is at short-term lows of around 48.8, Business tendency and consumer confidence continue to be sluggish.

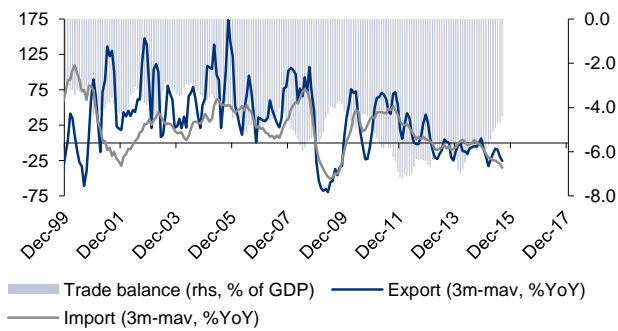
**Improvement in unemployment rate (SA) ended**

- The seasonally adjusted (SA) unemployment rate that had improved from Nov-14 to Apr-15 started increasing again and reached 10.4% in Jun-15, this year's highest reading. Labour force participation (SA), which had remained broadly unchanged and contributed to the drop in the unemployment rate in 1Q, increased again in the past two months and hit an all-time high of 51.4%, driving unemployment up again. Job creation was also weak in June, with a mere 19,000 (in sequential terms) added.
- Given lower consumer and investor confidence, the domestic demand recovery might cease in the second half of this year, which in turn might create further pressure in the labour market.

**Inflationary pressures still strong**

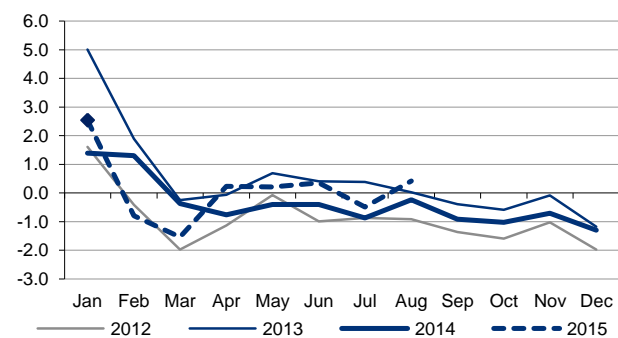
- CPI rose 0.89% in September, above market consensus at 0.75%. Stubborn food prices and FX pass-through impacted the monthly reading, despite favourable clothing prices. Accordingly, annual CPI, which hit a two-year low in July and rose in August, increased further from 7.14% to 7.95%.
- Movements in the currency market should determine the annual inflation trajectory, along with food and commodity prices, while base effects are likely to have a negative impact over the rest of this year. The data is likely to increase the pressure on the CBT for an earlier rate hike, given that annual inflation is above the target band and expectations are continuing to deteriorate.

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



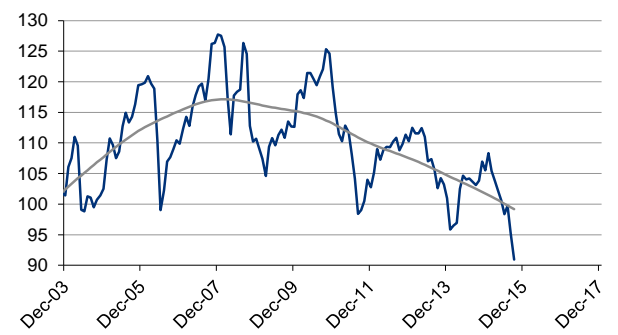
Source: Macrobond, ING estimates

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



Source: Macrobond, ING estimates

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



Source: Macrobond, ING estimates

**Sharp decline in the foreign trade deficit**

- The foreign trade deficit was US\$4.9bn in August, pulling the annual deficit – which had thus far shown a mild improvement in 2015 – down to US\$75.4bn from US\$78.6bn a month ago. Exports, hit by EUR weakness and weak major export markets such as Russia and Iraq, were US\$11.1bn, down 2.8% in August alone.
- Imports were US\$16.0bn, down a significant 18.2% YoY, having seen negative growth since Feb-14, driven mainly by a plunge in the energy bill. Excluding gold and energy, the 12M rolling trade deficit has deteriorated since the beginning of 2015 and contracted for the first time in August, hinting at some weakening in domestic demand.

**12M trailing primary surplus above the 2015 target**

- In the first eight months of the year, fiscal performance strengthened markedly, with a budget surplus of TRY0.6bn, comparing favourably with the TRY2.7bn deficit in the same period of 2014. The primary surplus, on the other hand, jumped by 26.2% YoY to TRY39bn, significantly above the end-year target.
- The surge in revenues was far stronger than the increase in non-interest expenditure, although this item, along with interest payments, recorded double-digit growth. Higher-than-anticipated revenues are attributable to healthy tax income generation, reflecting currency weakness as well as the recovery in domestic demand.

**Gross FX reserves drop further**

- The CBT's net FX position is c.US\$30bn, down from above US\$40bn in mid-Dec 2014. Gross FX reserves have dropped by over US\$10bn since Feb to below the US\$100bn threshold at end-Sep, due to directly meeting FX needs of energy-importing state-owned companies, direct FX sales and ROC adjustments.
- Capital flows were US\$13.8bn YTD, down from USD20.4bn in the same period of 2014 and accounting for only 54% of the cumulative c/a deficit, vs 76% a year ago. The remainder was financed by net errors and omissions (36%) and FX reserves (10%). Given this funding structure will continue in the coming period, pressure on FX reserves is likely to remain.

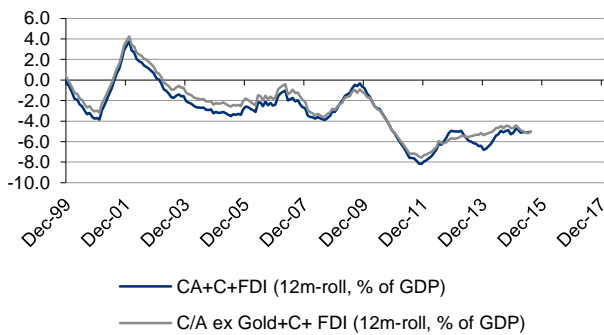
**Fig 8 Main macroeconomic recent releases**

Indicator		Previous -2	Previous -1	Actual	Surprise	Consensus		
Capacity Utilization (%)	Jul	75.9	Aug	74.8	Sep	75.9	-	
Industrial Confidence	Jul	105.4	Aug	103.7	Sep	99.1	-	
Industrial Production (SA WDA, MoM%)	Jun	2.1	Jul	-1.5	Aug	3.0	+	0.8
Industrial Production (WDA, YoY%)	Jun	4.9	Jul	0.3	Aug	7.2	+	2.1
Consumer Confidence	Jul	64.66	Aug	62.35	Sep	58.5	-	
Unemployment Rate (%)	Apr	9.6	May	9.3	Jun	9.6	+	9.2
GDP (SA WDA, QoQ%)	Q4	1.0	Q1	1.5	Q2	1.3	+	0.7
GDP (YoY%)	Q4	2.7	Q1	2.5	Q2	3.8	+	3.1
GDP (WDA, YoY%)	Q4	2.6	Q1	2.6	Q2	3.8	+	2.9
Core CPI (YoY%)C	Jul	7.3	Aug	7.7	Sep	8.2	+	7.9
CPI (YoY%)	Jul	6.8	Aug	7.1	Sep	8.0	+	7.7
PPI (YoY%)	Jul	5.6	Aug	6.2	Sep	6.9	+	6.4
1W Repo Rate Announcement (%)	Jul	7.50	Aug	7.50	Sep	7.50		7.50
Overnight Borrowing Rate Announcement (%)	Jul	7.25	Aug	7.25	Sep	7.25		7.25
Overnight Lending Rate Announcement (%)	Jul	10.75	Aug	10.75	Sep	10.75		10.75
Trade Balance (\$bn)	Jun	-6.2	Jul	-7.1	Aug	-4.9	+	-4.9
Current Account (\$bn)	May	-4.3	Jun	-3.3	Jul	-3.2	+	-3.6

Source: Bloomberg

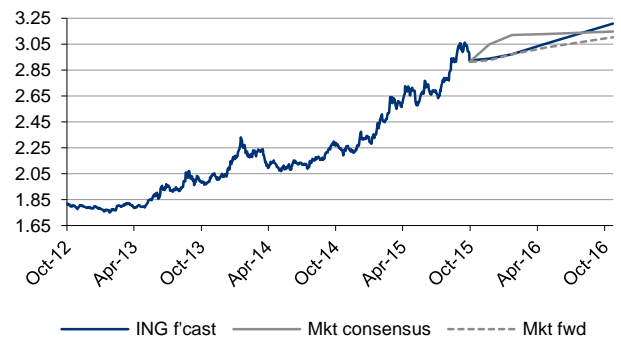
### Additional charts

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



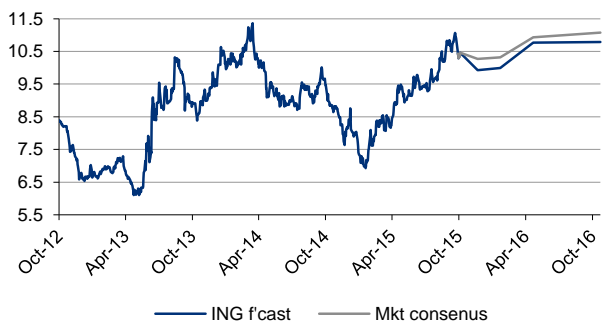
Source: Macrobond, ING estimates

**Fig 10 USD/TRY**



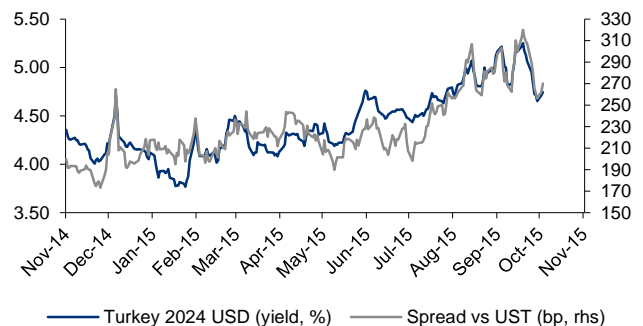
Source: Macrobond, ING estimates

**Fig 11 TR 10Y**



Source: Macrobond, ING estimates

**Fig 12 External debt**



Source: Macrobond, ING estimates

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