Economics

14 December 2015

MonitorING Turkey

Difficult geopolitical dynamics

Tension between Turkey and Russia has been rising following the downing of a Russian air force jet. Swiftly retaliating, Russia introduced a set of economic sanctions, putting economic ties between the two countries under pressure. The sanctions, specifically targeting Russian tourist inflows to Turkey, also include a ban on imports of certain products. The sanctions seem to be designed to inflict damage on Turkey while limiting the impact on Russia, as they exclude FDI and projects undertaken by Turkish contractors or energy imports. However, we might see a major impact on external balances.

Key points:

- Given the effects on the luggage trade, registered exports and tourist flows, we believe revenue losses from Russian sanctions might amount to 0.5-0.6% of GDP (USD4-5bn), though the government aims to reduce the pressure by directing some exports to other markets. Accordingly, c/a to GDP should exceed 5.0% in 2016.
- Due to the upside surprise in 3Q15 GDP and improving signals from recent indicators, we revise up our 2015 GDP growth forecast from 3.0% to 3.4%. We expect growth to slow to 3.0% in 2016 but, depending on the length of the sanctions, the chance of weaker growth performance has increased significantly.
- Ongoing inflationary pressures and a higher-than-expected November reading led us to revise our 2015 forecast for inflation from 8.1% to 8.6%. The plan to hike the minimum wage next year will also increase upside risks on inflation. We have increased our 2016 forecast from 7.1% to 7.5%. How the costs are shared between the government and the private sector is important, since employers are likely to pass on price increases to consumers.

Strategy:

FX: Turkey's large external imbalances, with a wide c/a deficit, foreign funding requirements and large currency risk carried by the corporate sector, expose the TRY to the impending Fed hike, as we have already recently witnessed. We expect further weakness ahead of the MPC, pushing the USD/TRY level towards 3.0. Any CBT action following the expected Fed lift-off in Dec might be supportive in the short-term. We expect further depreciation in 2016, though not as much as the rate witnessed this year.

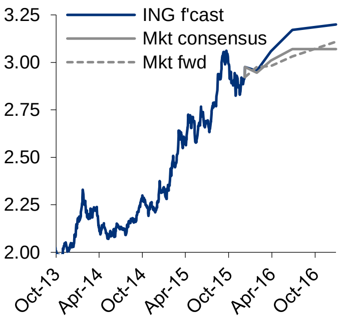
Local debt: The deteriorating inflation outlook and approaching Fed normalisation are keeping yields under pressure, with geopolitics also contributing. The CBT has already linked its framework simplification to Fed lift-off, meaning a more symmetric and narrower corridor around a higher policy rate. Thus, we expect the pressure to continue, given the difficult macro environment and challenging external funding conditions.

Quarterly forecasts

	3Q15	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F	2Q17F
Real GDP (%YoY)	4.0	3.4	2.2	3.0	3.2	3.6	3.5	3.7
CPI (eop, %YoY)	7.9	8.6	7.9	7.8	7.6	7.5	7.2	7.0
Central bank key rate (eop, %)	7.50	8.00	8.50	9.00	9.00	9.50	10.00	10.50
3m interest rate (eop, %)	12.18	11.04	11.00	11.00	11.00	11.00	11.00	11.00
10yr yield (eop, %)	11.03	10.34	10.44	10.79	10.72	11.07	11.59	12.04
USD/TRY exchange rate (eop)	2.68	2.95	3.06	3.17	3.18	3.20	3.26	3.33
EUR/TRY exchange rate (eop)	3.00	3.10	3.12	3.11	3.34	3.52	3.65	3.83

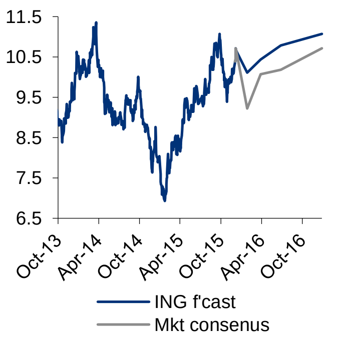
Source: Macrobond, ING estimates

USD/TRY



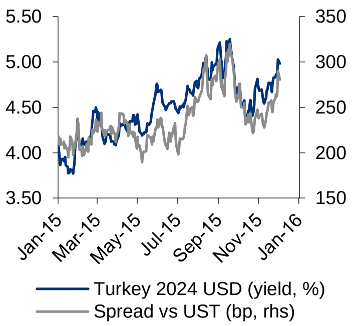
Source: Macrobond, ING estimates

Local 10Y yields



Source: Macrobond, ING estimates

US$ Eurobond 10Y



Source: Bloomberg, Reuters

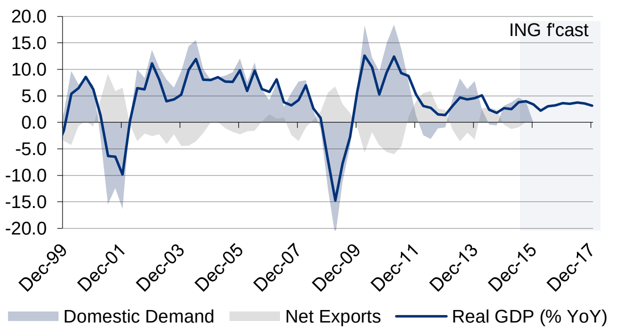
Latest indicator surprises

Output	Positive
Consumption	Negative
Inflation	Higher
External	Positive
Budget	Neutral

Source: Bloomberg

Muhammet Mercan
Chief Economist
Istanbul +90 212 329 0751
muhammet.mercan@ingbank.com.tr

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

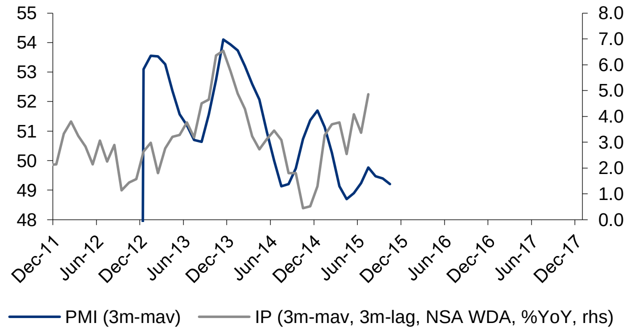


Source: Macrobond, ING estimates

Upside surprise in 3Q15 growth

- Economic activity was better than expected in 3Q15, with 4.0% YoY growth. Private demand remained a main driver, though weakened markedly in comparison to 2Q15, along with slight support from public demand. Net exports and inventories that weighed on growth performance supported this time.
- Lower political risk anticipation in the aftermath of the elections should support the growth performance in the rest of 2015, as already hinted by improving business and consumer sentiment. Additionally, a credible reform programme and dedicated implementation would support the long-term growth outlook. On the downside, escalating tension with Russia might be a drag.

Fig 2 IP vs PMI

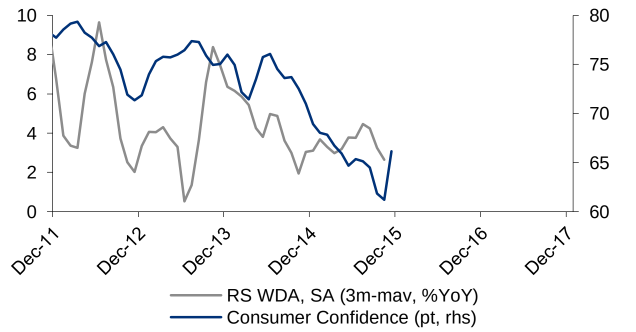


Source: Macrobond, ING estimates

IP remained flat in the last two months

- Seasonal and calendar-adjusted IP, which recorded a strong increase in August, remained practically unchanged in the following two months on a sequential basis, around an all-time high level. Sector-wise, manufacturing production slightly increased and determined the monthly performance along with a positive reading in mining and quarrying, though electricity, gas, steam and air conditioning supply pulled the headline down.
- Recent indicators, including better consumer sentiment and business tendency, improving PMI (to the highest level seen in 2015), and reviving momentum in lending to corporates in recent weeks, hint that IP may strengthen in November.

Fig 3 Retail sales vs consumer confidence

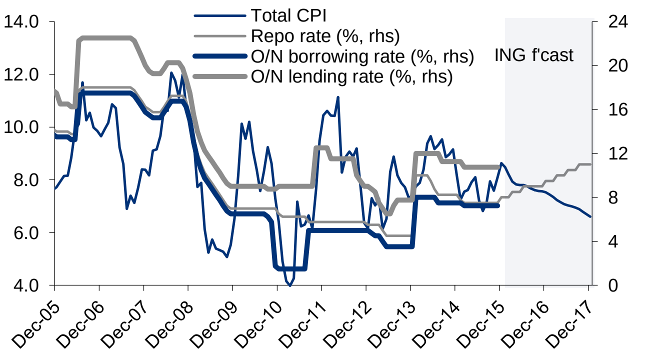


Source: Macrobond, ING estimates

Consumer confidence sharply recovers

- Consumer confidence dropped markedly in 2015 due to volatility in financial markets, geopolitical risks and domestic politics, though retail sales somewhat diverged as white goods and auto sales remained resilient. The data in 4Q indicates a sharp recovery in confidence from the lowest levels since the 2009 recession, with improvement in the political risk premium in the aftermath of the general elections, allowing a stable single party government.
- We see a consequent increase in retail sales volumes in seasonally adjusted terms, although mainly stemming from food, while non-food became less sluggish in October. In November, we should see some further improvement in sales activity.

Fig 4 CPI vs policy rate

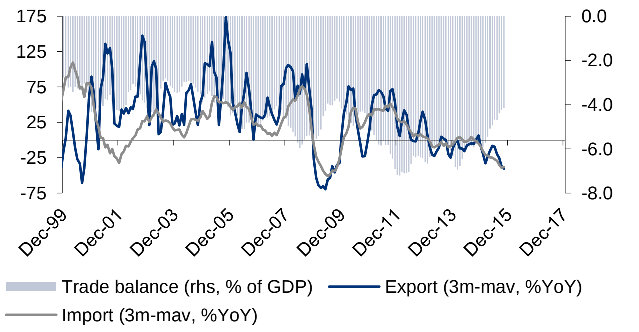


Source: Macrobond, ING estimates

November CPI paints a problematic picture

- CPI rose 0.67% last month, driven mainly by clothing and food prices, and despite favourable energy prices. Accordingly, annual CPI, which has increased since Jul (except Oct), rose from 7.58% to 8.10%, with negative base effects also contributing. All of the nine core indices have seen increases on an annual basis, showing the influence of the cumulative depreciation in the TRY.
- Going forward, movements in the currency market should determine the annual inflation trajectory, along with commodity prices. It should be noted that Russian sanctions on Turkish agricultural products might ease fruit, vegetable and poultry prices, as some anecdotal evidence has already shown.

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

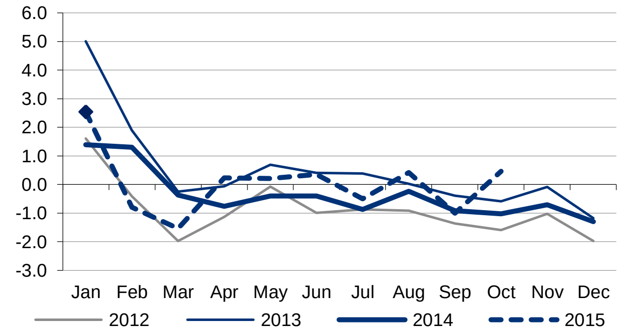


Source: Macrobond, ING estimates

Sharp decline in the foreign trade deficit

- The foreign trade deficit came in at USD3.6bn in Oct, pulling the annual deficit, which had shown accelerated improvement in recent months, down to USD69.6bn. Exports that were hit by weakness in the euro and lower demand from major oil exporters have increased for the first time in 2015, rising by 3.1% so far. Imports dropped by a significant 11.9% YoY, and have continued to register negative growth rates since Feb-14, driven mainly by a plunge in the energy bill. More working days in Oct-15 vs Oct-14 also impacted the data.
- Going forward, this trend should prevail, though punitive economic sanctions introduced by Russia against Turkey might create pressure on external balances given the close trade ties.

Fig 6 Budget performance YTD (% GDP)

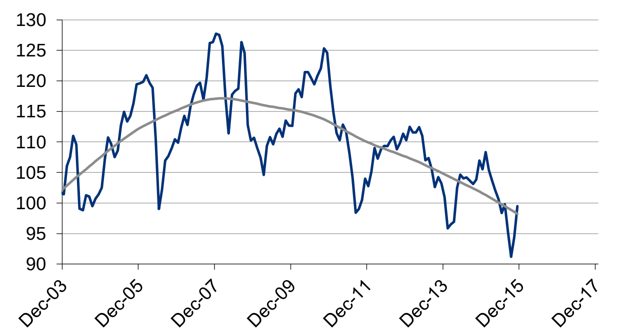


Source: Macrobond, ING estimates

Further strength in fiscal metrics

- The budget recorded a large surplus of TRY7.2bn in Oct vs a deficit of TRY3.0bn in the same month of 2014, hinting at a continuation of fiscal discipline during the election cycle and a modest impact from weakening domestic demand. The 12M rolling deficit dropped significantly to a mere TRY14.0bn, translating into 0.7% of GDP, the lowest in the last seven years. This compares with the official target of 1.3%. In 2016, the government will raise the minimum wage by 30% as part of the election promises, and has already signalled that it will share the cost. However, given that the deficit target for 2016 in the MTP is already low at 0.7% of the GDP, fiscal performance after the inclusion of the election costs should still be manageable.

Fig 7 FX: REER vs trend (index)



Source: Macrobond, ING estimates

CBT awaiting the Fed move

- In Nov, the MPC statement is almost a carbon copy of last month's note, with the exception of a few modifications. The CBT does not refer anymore to weak external demand conditions and contributions from domestic demand to the headline growth in the first half of the year, though it sees more contribution from exports on the back of relatively better demand conditions in Eurozone.
- We continue to think that the first CBT move may come later in Dec-15 or Jan-16, as ING currently sees a possibility of a December hike. Hence, the bank will continue to watch any action on this side, while keeping money market rates elevated in the near term.

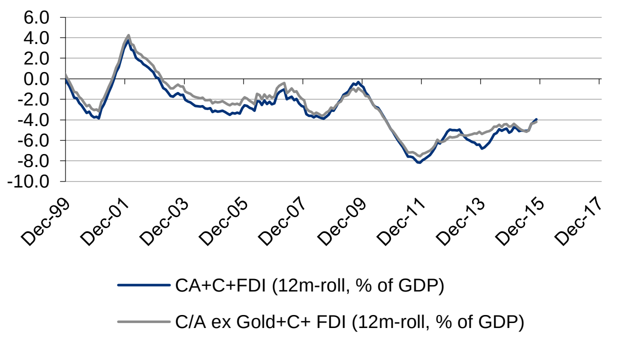
Fig 8 Main macroeconomic recent releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilization (%)	Sep	75.9	Oct	75.5	Nov	75.9		-
Industrial Confidence	Sep	99.1	Oct	100.5	Nov	105.2		-
Industrial Production (SA WDA, MoM%)	Aug	3.0	Sep	-0.1	Oct	0.1	+	-0.6
Industrial Production (WDA, YoY%)	Aug	7.2	Sep	2.8	Oct	4.6	+	3.9
Consumer Confidence	Sep	58.52	Oct	62.78	Nov	77.2		-
Unemployment Rate (%)	Jun	9.6	Jul	9.8	Aug	10.1	+	9.9
GDP (SA WDA, QoQ%)	Q1	1.5	Q2	1.4	Q3	1.3	+	0.4
GDP (YoY%)	Q1	2.5	Q2	3.8	Q3	4.0	+	2.7
GDP (WDA, YoY%)	Q1	2.6	Q2	3.8	Q3	5.4	+	3.3
Core CPI (YoY%)C	Sep	8.2	Oct	8.9	Nov	9.2	+	9.0
CPI (YoY%)	Sep	8.0	Oct	7.6	Nov	8.1	+	7.8
PPI (YoY%)	Sep	6.9	Oct	5.7	Nov	5.3		-
1W Repo Rate Announcement (%)	Jul	7.50	Aug	7.50	Nov	7.50		7.50
Overnight Borrowing Rate Announcement (%)	Jul	7.25	Aug	7.25	Nov	7.25		7.25
Overnight Lending Rate Announcement (%)	Jul	10.75	Aug	10.75	Nov	10.75		10.75
Trade Balance ($bn)	Aug	-4.9	Sep	-3.8	Oct	-3.6	+	-4.0
Current Account ($bn)	Aug	0.2	Sep	0.1	Oct	-0.1	+	-0.2

Source: Bloomberg

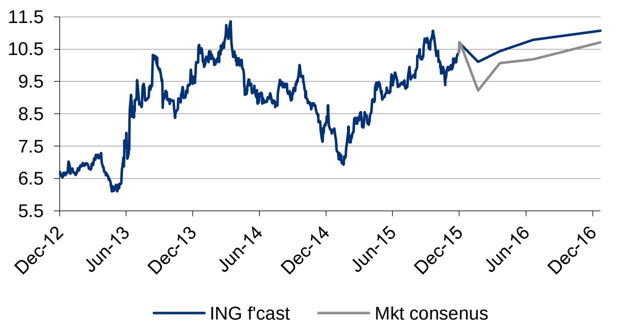
Additional charts

Fig 9 C/A (% of GDP) annual



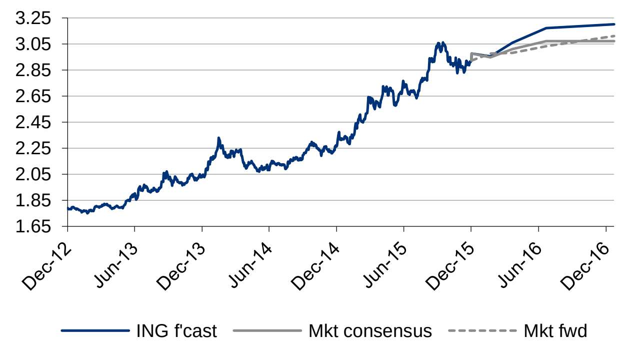
Source: Macrobond, ING estimates

Fig 10 FI 10Y (yield)



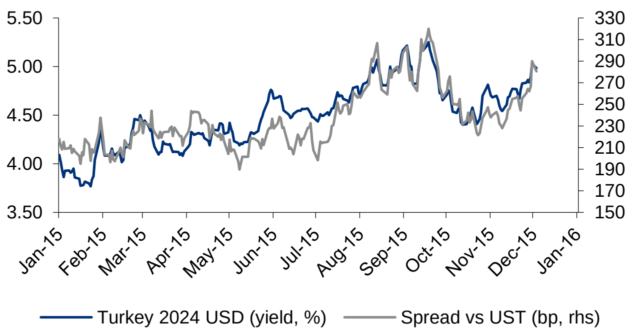
Source: Macrobond, ING estimates

Fig 11 USD/TRY



Source: Macrobond, ING estimates

Fig 12 External debt



Source: Macrobond, ING estimates

ING Bank A.Ş. Economic Research Group

Muhammet Mercan Chief Economist + 90 212 329 0751 muhammet.mercan@ingbank.com.tr

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