

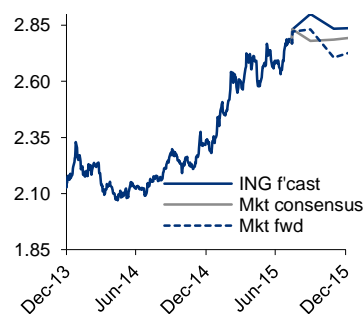
Economics

17 August 2015

MonitorING Turkey

Uncertainty to linger further

USD/TRY



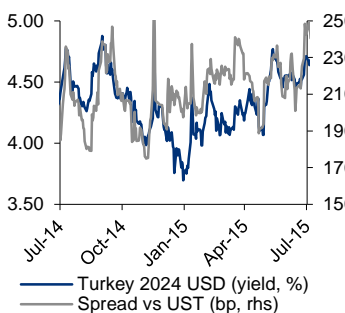
Source: Macrobond, ING estimates

Local 10Y yields



Source: Macrobond, ING estimates

US\$ Eurobond 10Y



Source: Bloomberg

Latest indicator surprises

Output	Positive
Consumption	Negative
Inflation	Lower
External	Neutral
Budget	Neutral

Source: Bloomberg

Muhammet Mercan

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

With the AKP-CHP coalition negotiations failing last week, Turkey heads to another general election, possibly at the end of November. President Erdoğan can call snap elections if a government cannot be formed by 23 August, the official deadline for parties to form a coalition. However, there is still a possibility of the AKP trying to form a minority government before the deadline, with the intent of taking Turkey to early general elections, either with the explicit or implicit support of MHP. The continuation and deepening of political uncertainty has weighed on macro indicators so far. Given this backdrop, we expect no major decisions to be taken and all reforms to be delayed, with consequent growing downside risks to the economic outlook.

Key points:

- The current political scenario shows that Turkey is likely to have another round of elections in October or November, to extend the possibility of forming a new government to 2016. Continued political uncertainty against a global backdrop of rate normalisation by the Fed and growing geopolitical risks should further drag down already-weak growth performance, in the second half of this year and next year.
- Accordingly, we downgrade our 2015F growth estimate from 3.1% to 2.9% and 2016F from 3.5% to 3.1%.
- The main focus in the month ahead is likely to be the August MPC, as the CBT announced last month that it might gradually abandon the interest rate corridor and ultimately start using a single policy rate again. When and how this move will be made is unclear as yet, while details are expected to be unveiled this month, with the submission of a technical report to the MPC.

Strategy:

FX: TRY remained under a weakening bias on the back of political issues and geopolitical developments, with increasing domestic security concerns. We expect market sentiment to continue to be fragile and TRY to maintain volatility, given macro imbalances and an uncertain political backdrop.

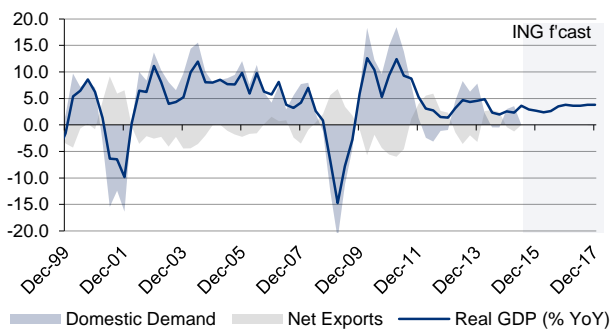
Local debt: Given the uncertainty surrounding the new monetary policy framework and the weak risk appetite for TRY assets due to geopolitical risks and extended domestic political uncertainty, we do not currently see a scope for decline. The CBT should keep liquidity conditions tight despite support from a drop in oil prices.

Quarterly forecasts

	1Q15	2Q15	3Q15F	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F
Real GDP growth (%YoY)	2.3	3.6	2.9	2.7	2.4	2.6	3.5	3.8
CPI (%YoY) eop	7.6	7.2	7.2	7.2	7.7	6.6	6.5	7.1
Policy interest rate (%) eop	7.50	7.50	8.00	8.00	8.50	8.50	9.00	9.00
3-month interest rate (%) eop	10.50	11.34	11.70	11.11	10.63	10.46	10.64	10.84
10-year yield (%) eop	8.44	9.36	10.07	9.30	9.51	9.51	9.78	10.08
Exchange rate (USDTRY) eop	2.60	2.68	2.95	2.80	2.88	2.93	2.97	3.00
Exchange rate (EURTRY) eop	2.79	2.99	3.16	2.94	2.94	2.87	2.97	3.06

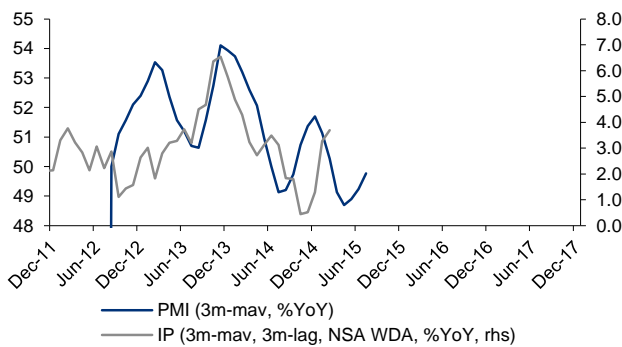
Source: Macrobond, ING estimates

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



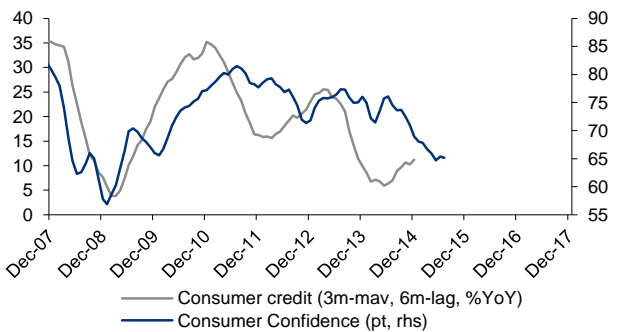
Source: Macrobond, ING estimates

Fig 2 IP versus PMI



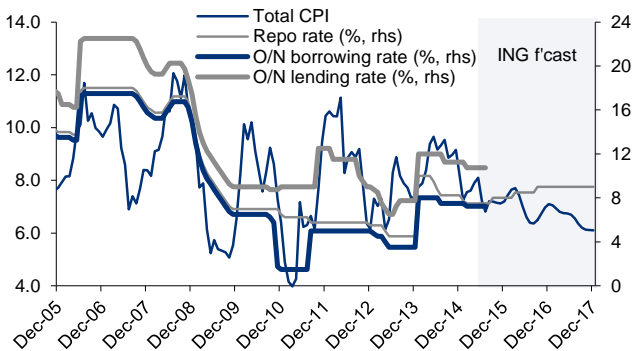
Source: Macrobond, ING estimates

Fig 3 Consumer confidence versus credit



Source: Macrobond, ING estimates

Fig 4 CPI versus policy rate



Source: Macrobond, ING estimates

Growth prospects likely to deteriorate

- IP data in 2Q hints at recovery in momentum, driven by improving consumption demand despite relatively lower contribution from investments. Another indicator, July PMI, also indicated that economic activity is gradually picking up after signs of a soft patch in the previous month.
- However, given that Turkey is heading for another round of elections with the failure of coalition negotiations between AKP and CHP, the continued political uncertainty could result in weaker growth prospects in the second half of this year. Additionally, a looming Fed lift-off and growing geopolitical risks indicate further deterioration in an already modest growth outlook for 2015.

Strong recovery in June IP

- IP has remained in positive territory and turned out to be better than expected in June at 5.5% YoY, the highest since the beginning of last year. Seasonally-adjusted IP expanded markedly by 2.4% on sequential basis, showing a correction following a significant drop a month ago, with the end of protests/strikes in the automotive sector. The QoQ change in three-month average IP stood at 1.6%, and improved over 1Q15.
- Pharmaceuticals and coke & refined petroleum products that pulled headline numbers up in the last five months, stood out as the major contributors in June along with the automotive sector, due to a resumption of production following waves of labour strikes and food products.

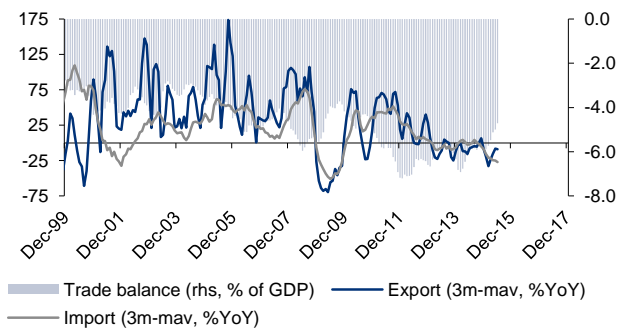
Share of services in employment following an uptrend

- The seasonally-adjusted (SA) unemployment rate dropped in April to 9.9%, the lowest level in almost a year, gradually improving since Nov-14. Labour force participation (SA) remained unchanged at 51.0%, close to its all-time high level. After a strong uptrend since the beginning of 2012, labour participation seems to be stagnant around this level in recent times, also helping the unemployment rate.
- 101K new jobs (SA) were created in April; the non-agricultural sector was the major contributor with 88K, driven by services (93K) and industry (18K), despite a decline in the number of jobs in the construction sector (-23K). As a result, services' share in employment figures reached 52% and maintained its uptrend.

July CPI slightly above the consensus

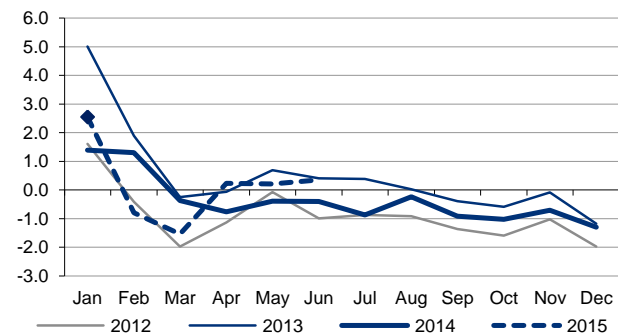
- The CPI rose 0.09% last month due to still-strong food prices (higher than the July average over the last 10 years) and FX pass-through and despite favourable clothing prices. Accordingly, annual CPI dropped to 6.8%, the lowest level realised in more than two years. Annual inflation in all eight core indicators dropped last month, hinting that inflationary pressures are relatively benign despite the continuing impact of exchange-rate developments.
- Although the annual price change in the food group remained broadly unchanged, currently running close to the historical average; non-food inflation declined 5.2% in July, from 5.8% a month ago, attributable to the recent improvement in metal and energy prices.

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



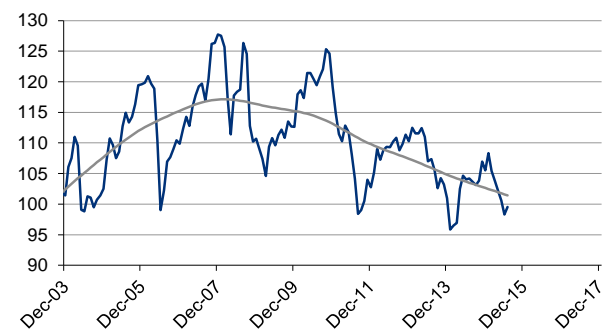
Source: Macrobond, ING estimates

Fig 6 Budget performance YTD (% of GDP)



Source: Macrobond, ING estimates

Fig 7 FX: REER versus trend (index)



Source: Macrobond, ING estimates

Trade deficit shrank further in June

- The foreign trade deficit was USD6.2bn in June, pulling an annual deficit that has followed a downtrend since end-2013 down to USD78.1bn, from USD79.8bn a month ago, showing a relative acceleration in 2Q after stagnating in 1Q. Excluding gold and energy, the trade deficit deteriorated since the beginning of the year, possibly hinting at some strengthening in domestic demand.
- The share of exports to the MENA region increased with the support of strong export growth to Iran, Saudi Arabia and Egypt, despite geopolitics weighing on Iraq trade. The share of exports to the EU remained virtually unchanged in June, although it declined in 1H, reflecting the adverse effect of a sharp drop in EUR/USD parity.

Budget balance at a surplus in June

- The central administration's budget balance turned out to be a surplus of TRY3.2bn in June vs a TRY0.6bn deficit in Jun-14, a marked improvement as total revenue expanded significantly at 14.5% YoY, while expenditure recorded a modest growth of 3.1% on the primary spending side and 7.6% in interest expenses.
- On a cumulative basis, the budget balance stood at a TRY0.8bn surplus in the first half of 2015, in comparison to a TRY0.6bn deficit in the same period in 2014, while the primary surplus increased by 32% YoY to TRY30.5bn. Interest expenditure that grew by more than 35% during the Jan-Apr period continued to normalise in May and June, given an uneven repayment pattern at the Treasury.

CBT to adjust policy framework

- Last month, the CBT governor signalled that the need for a wide interest rate corridor may diminish in the coming period, as a consequence of permanently declining volatility in long-term interest rates, following the start of normalisation of the Fed's monetary policy. According to the CBT, this environment might facilitate a gradual simplification of the operational framework of the CBT's policy, implying a return to orthodox policy.
- The initial stage of policy normalisation may lead to further weakening in TRY, while reducing the upper band of the policy corridor is a key risk to TRY assets as it may initially test the CBT's flexibility in quickly adjusting policy setting during times of stress.

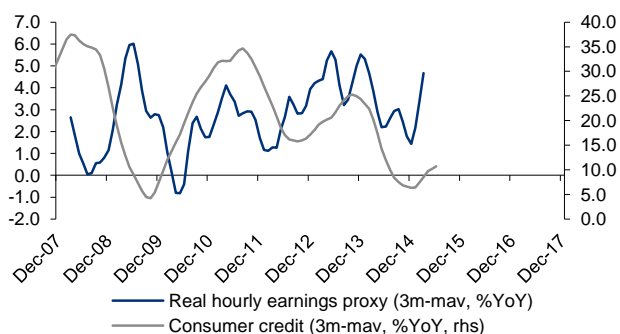
Fig 8 Main recent macroeconomic releases

Indicator		Previous -2		Previous -1		Actual	Surprise	Consensus
Capacity utilisation (%)	May	74.9	Jun	75.1	Jul	75.9	+	75
Industrial Confidence	May	109	Jun	104.9	Jul	105.4	-	-
Industrial Production (SA WDA, MoM%)	Apr	0.0	May	-1.9	Jun	2.4	+	0.8
Industrial Production (WDA, YoY%)	Apr	3.9	May	2.4	Jun	5.5	+	3.0
Consumer Confidence	May	64.3	Jun	66.4	Jul	64.7	-	-
Unemployment rate (%)	Mar	10.6	Apr	9.6	May	9.3	+	9
GDP growth (SA WDA, QoQ%)	Q3	0.4	Q4	0.8	Q1	1.3	+	0.7
GDP growth (YoY%)	Q3	1.9	Q4	2.6	Q1	2.3	+	1.7
GDP growth (WDA, YoY%)	Q3	1.9	Q4	2.5	Q1	2.4	+	1.7
Core CPI (YoY%)	May	7.5	Jun	7.5	Jul	7.3	+	7.3
CPI (YoY%)	May	8.1	Jun	7.2	Jul	6.8	-	6.8
PPI (YoY%)	May	6.5	Jun	6.7	Jul	5.6	-	6.6
1W Repo Rate announcement (%)	Apr	7.50	May	7.50	Jul	7.50		7.50
Overnight Borrowing Rate announcement (%)	Apr	7.25	May	7.25	Jul	7.25		7.25
Overnight Lending Rate announcement (%)	Apr	10.75	May	10.75	Jul	10.75		10.75
Trade balance (US\$bn)	Apr	(5.0)	May	(6.8)	Jun	(6.2)	+	(6.3)
Current account (US\$bn)	Apr	(3.8)	May	(4.4)	Jun	(3.4)	-	(3.2)

Source: Bloomberg

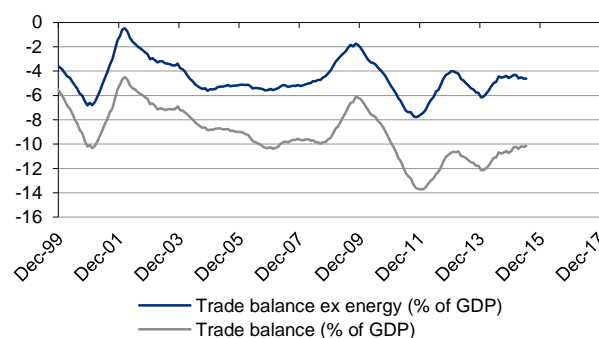
Additional charts

Fig 9 Wages and credit growth



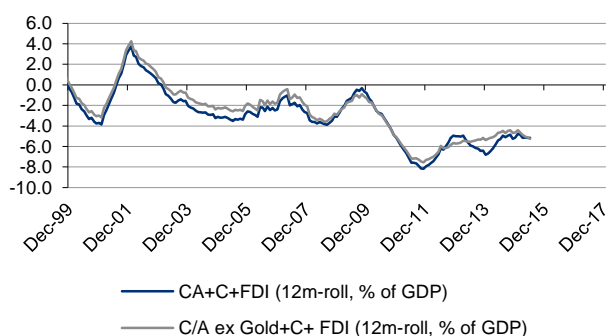
Source: Macrobond, ING estimates

Fig 10 Trade balance (annual)



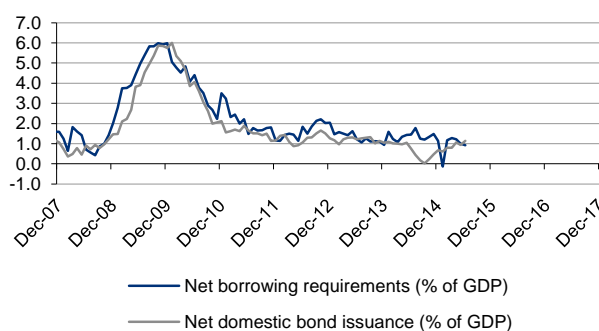
Source: Macrobond, ING estimates

Fig 11 Current and capital accounts + net FDI



Source: Macrobond, ING estimates

Fig 12 Govt central borrowing requirements (annual)



Source: Macrobond, ING estimates

ING Bank A.Ş. Economic Research Group

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

DISCLAIMER:

Investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided in accordance with a contract of engagement on investment advisory concluded between brokerage houses, portfolio management companies, non-deposit banks and clients. Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely to this information stated here may not bring about outcomes that fit your expectations.

This report has been prepared by ING Bank A.Ş. Economic Research Group solely for the information purposes of its readers. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, ING Bank A.Ş. makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Neither ING Bank A.Ş. nor any of its officers or employees accepts any liability for any direct or consequential loss arising from any use of this report or its contents. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING Bank A.Ş. All rights are reserved.

ING Bank A.Ş. is responsible for the distribution of this report in Turkey.