

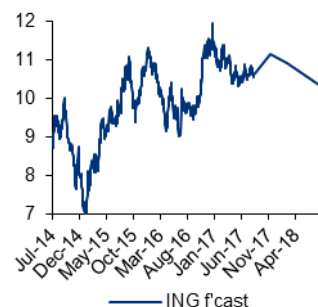
Emerging Markets  
6 September 2017

**USD/TRY**



Source: Reuters, ING estimates

**Local 10Y yields**



Source: Reuters, ING estimates

**US\$ Eurobond 30Y**



Source: Reuters, ING estimates

**Latest indicator surprises**

Output	Negative
Consumption	Positive
Inflation	Higher
External	Neutral
Budget	Neutral

Source: Bloomberg

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# MonitorING Turkey

## Strengthening price pressures

Annual inflation returned to double digits, as expected, though with a sharper increase than envisaged earlier, attributable to a reversal in goods inflation, while services inflation remained practically unchanged. It remains a major concern, given continuing producer-driven cost pressures and further deterioration in core outlook.

- Despite ongoing appreciation pressures that pulled USD/TRY down by more than 2.5% in recent days, we revise our 2017 and 2018 inflation forecasts, given a significantly higher than envisaged August reading and ongoing strong demand, thanks to the contribution from credit expansion with easing macro-prudential measures, the credit guarantee fund and supportive fiscal policy. We expect 9.7% inflation for this year and 8.0% for the next. Strengthening price pressures and a more elevated inflation path are likely to contribute to stickiness in inflation expectations, while improving TRY stability could increase downside risks in the period to come. The Food Committee's decision to adjust taxation to bring down the cost of meat production is likely to be supportive for already high food inflation.
- Markets will look for a strong 2Q17 GDP reading, given the impact from supportive government measures, a recovery in tourism (thanks to the lifting of Russian sanctions), an improving political backdrop in the aftermath of the referendum in April and accelerating exports (on a recovering economic performance in the EU). Given the strength of high-frequency economic activity data, despite significant CBT tightening, we expect 5.3% GDP growth in 2Q17. At the September MPC, we expect the CBT to remain cautious on the direction of monetary policy and not change the current funding composition and average cost of funding rate.

**FX and money markets:** A carry-friendly external environment with general USD weakness has contributed to recent TRY performance, also supported by growth resilience and monetary policy tightness. Despite large external imbalances and a change in the course of inflation, expected loss of momentum in economic activity and ongoing political tension with Germany and the EU arguing in favour of a cautious approach, a supportive capital flow outlook will continue to determine performance in the near term.

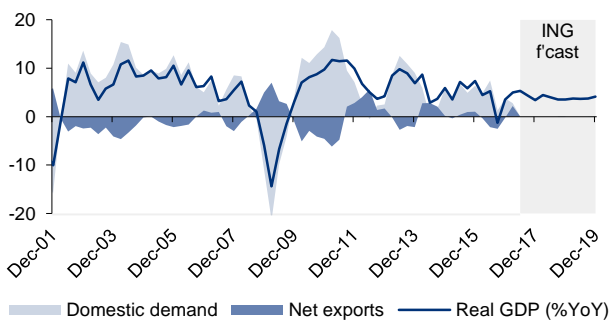
**Domestic debt and rates:** Still-elevated headline and inflation expectations, ongoing geopolitical issues with the possibility of applying pressure on market prices and bouts of volatility in global financial markets are likely to keep the CBT cautious. We see limited room for a sharp rally in bonds in the near term, given no room for early easing by the CBT, while a high domestic roll-over ratio with likely additional pressure over the remainder of the year also weigh on nominal yields.

**Quarterly forecasts**

	1Q17	2Q17	3Q17F	4Q17F	1Q18F	2Q18F	3Q18F	4Q18F
Real GDP (%YoY)	5.0	5.3	4.3	3.4	4.5	4.0	3.5	3.5
CPI (eop, %YoY)	11.3	10.90	11.1	9.7	7.8	7.9	7.7	8.0
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	12.74	12.24	11.67	11.33	11.02	10.75
10yr yield (eop, %)	10.93	10.53	10.83	11.19	10.72	10.48	10.27	10.11
USD/TRY exchange rate (eop)	3.63	3.52	3.47	3.55	3.64	3.73	3.82	3.90
EUR/TRY exchange rate (eop)	3.92	3.94	4.17	4.26	4.37	4.66	4.85	5.07

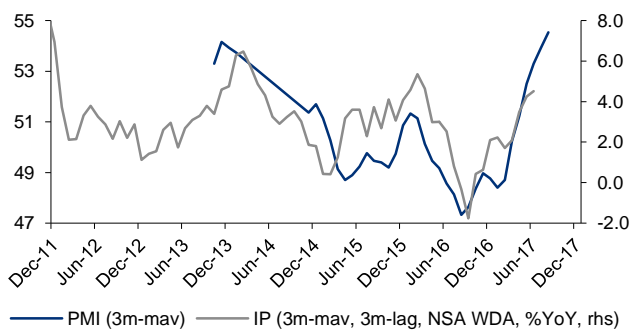
Source: Reuters, ING estimates

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



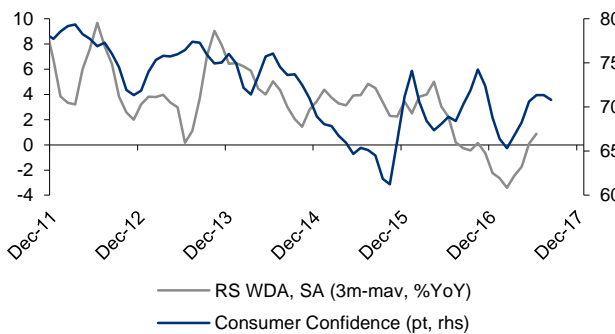
Source: TurkStat, ING estimates

**Fig 2 IP vs PMI**



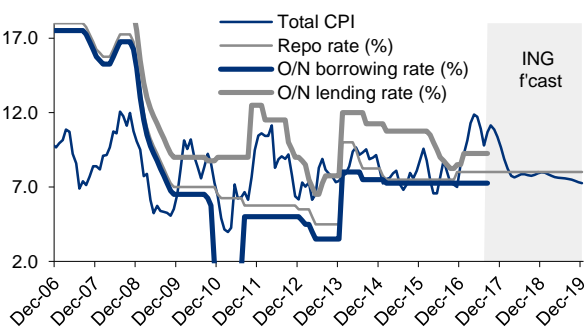
Source: Markit, TurkStat, ING estimates

**Fig 3 Retail sales vs consumer confidence**



Source: TurkStat, ING estimates

**Fig 4 CPI vs policy rate**



Source: CBT, ING estimates

**Growth is robust this year**

- The Turkish economy has embarked on a recovering trend, with increasing contributions from private consumption and net exports, while government consumption has also provided a strong uplift. Improvement in economic activity is likely to continue in 3Q17, due to further support from fiscal policy measures, resilient consumer demand and ongoing recovery in net exports. However, the last quarter of this year is likely to witness some loss in momentum, as the government is due to reverse the VAT cut on certain consumer durables and the social security premium cut on new employment in 4Q17.
- Accordingly, we expect GDP growth of 4.4% this year, though risks are clearly to the upside.

**PMI paints an optimistic picture**

- After taking a hit from the failed coup attempt last year, the seasonally adjusted PMI for manufacturing has been on a fluctuating upward trend, exceeding the 50 threshold in Mar-16. At the latest August reading, PMI had risen to a six-year high of 55.3, reflecting a continuation of recovery in business conditions.
- Survey data reveals rapid growth in new orders and purchasing, while output is expanding at its highest rate since early 2011. Employment growth accelerated along with purchasing activity. The August PMI signalled a sharper increase in domestic new business than in new export orders, a slight strengthening of inflationary pressures and growing pressure on capacity, with rising backlogs.

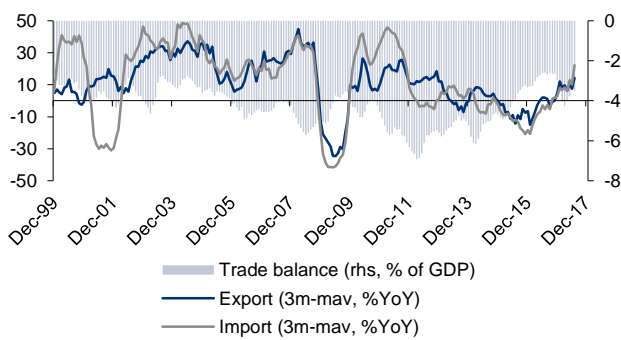
**The unemployment rate remained flat in May**

- The seasonally adjusted unemployment rate recovered in the first four months of 2017 with the support of government measures and stood at 11.3% in May, unchanged MoM. The participation rate was 52.6%, flat in comparison to the previous month and still close to all-time highs. On the flipside, the unadjusted unemployment rate recorded a marked increase to 10.2%, from 9.4% a year ago, showing ongoing weakness in the labour market.
- On a sequential basis, job creation was at 44K MoM, losing momentum in 2Q17, vs 1Q17. The breakdown of labour data reveals that the youth unemployment rate (SA) that dropped in 1Q17 increased again in 2Q17, standing at 21.9% in May.

**Annual inflation returns to double digits**

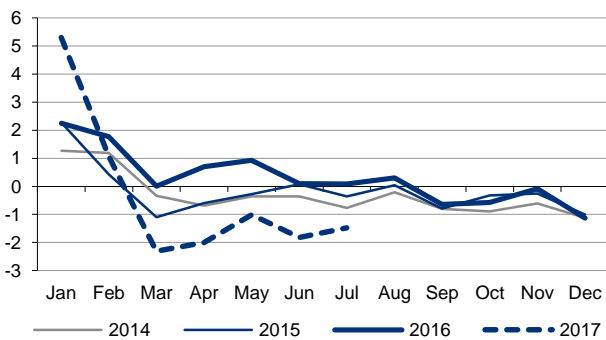
- The CPI at 0.52% MoM in August was higher than consensus. The figure ended the headline disinflation trend since the peak in April and pulled annual inflation up to double digits at 10.7%, from 9.8% a month ago. Price hikes were spread across all categories, with the exception of seasonal declines in food and clothing.
- Core inflation recorded a 0.49% change in August, pulling annual inflation up to 10.2%, the first double-digit reading since Apr-12. The data shows a continuation of the impact from the currency, as core figures stay elevated with no clear sign of a downtrend yet, though ongoing TRY strength is likely to be supportive for the core outlook in the coming period.

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



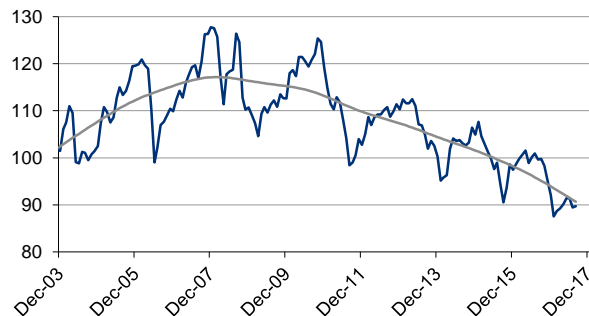
Source: TurkStat, ING estimates

**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

**12M rolling trade deficit at the highest since 2015**

- The foreign trade deficit arrived at USD8.8bn in July, pulling the 12M rolling deficit up from USD58.9bn to USD62.9bn, the highest since end-2015. Due to less working days owing to the Ramadan holiday and, hence, a lower base effect in the same month in 2015, exports and imports surged YoY, though import growth turned out to be stronger at 46.2%, vs 28.3% in exports.
- Apart from working days, the ongoing uptrend in gold imports (likely to replenish inventories) and a growing energy bill have contributed to the higher expansion in imports. Exports, on the other hand, were supported by TRY-driven competitiveness gains and the recovery in European economies.

**Budget surplus in July**

- The July outcome shows strength in revenue generation (up 24.3% YoY), while momentum in primary expenditures has continued, with a 19.8% rise YoY. We also saw a sharp 37.2% jump YoY in interest expenses, due to the Treasury's uneven repayment schedule. Accordingly, the seasonal primary surplus of TRY4.3bn in July last year expanded to TRY6.7bn this year, up 54.5%.
- On a cumulative basis, the budget balance was in deficit by TRY24.3bn over Jan-Jul 2017, vs a TRY1.3bn surplus in the same period of 2016. The primary surplus also fell by 74%, showing the extent of the deterioration. We see an expansion in the 12M rolling deficit this year to its highest since the global crisis, in TRY terms.

**Policy direction to remain unchanged**

- Following the end of the tightening cycle in June with the downtrend in inflation, calm on the domestic political front and the supportive external backdrop, the CBT has remained mute over the summer months.
- The CBT is unlikely to make any change in policy direction, given continuing pressures on inflation outlook, along with core inflation at double-digit levels, strength in activity and less pressure on deposit rates (owing to some momentum loss in lending expansion) are against an early easing. On the flip side, ongoing TRY stability and a conducive global environment are major arguments against any further tightening. As a result, we do not expect any near-term change in the current funding composition and average cost of funding rate to follow.

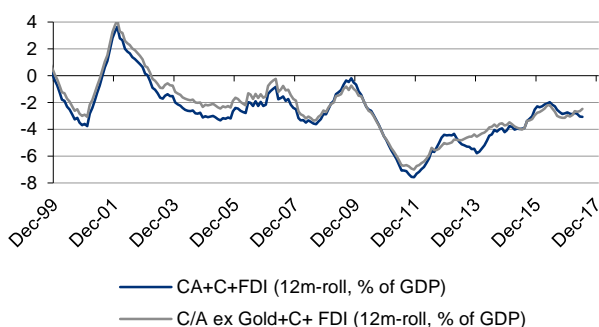
**Fig 8 Main recent macroeconomic releases**

Indicator		Previous -2		Previous -1		Actual	Surprise	Consensus
Capacity Utilisation (%)	Jun	79	Jul	78.7	Aug	78.8	+	78.7
Industrial Confidence	Jun	112.4	Jul	109.5	Aug	110.7		-
Industrial Production (SA WDA; MoM%)	Apr	2.2	May	-1.4	Jun	-0.4	-	0.4
Industrial Production (WDA; YoY%)	Apr	6.7	May	3.5	Jun	3.4	-	3.6
Consumer Confidence	Jun	70.0	Jul	71.3	Aug	71.1		-
Unemployment Rate (%)	Mar	11.7	Apr	10.5	May	10.2	-	10.2
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%)	Jun	9.2	Jul	9.6	Aug	10.2	+	9.8
CPI (YoY%)	Jun	10.9	Jul	9.8	Aug	10.7	+	10.2
PPI (YoY%)	Jun	14.9	Jul	15.5	Aug	16.3	+	16.0
1W Repo Rate Announcement (%)	Apr	8.00	Jun	8.00	Jul	8.00		8.00
Overnight Borrowing Rate Announcement (%)	Apr	7.25	Jun	7.25	Jul	7.25		7.25
Overnight Lending Rate Announcement (%)	Apr	9.25	Jun	9.25	Jul	9.25		9.25
Trade Balance (US\$bn)	May	-7.3	Jun	-6.0	Jul	-8.8	-	-8.8
Current Account (US\$bn)	Apr	-3.7	May	-5.4	Jun	-3.8	+	-3.9

Source: Bloomberg

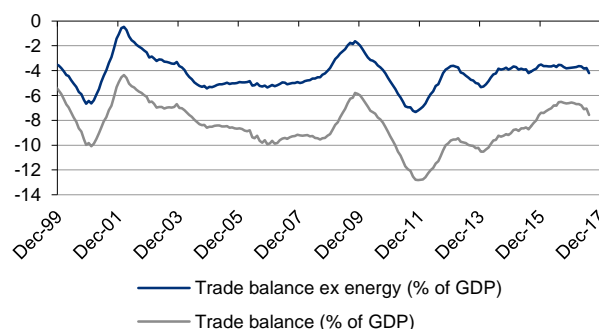
### Additional charts

**Fig 9 Current Account (annual; % of GDP)**



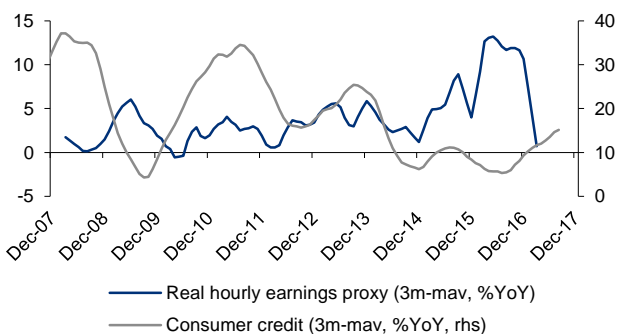
Source: CBT, ING estimates

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



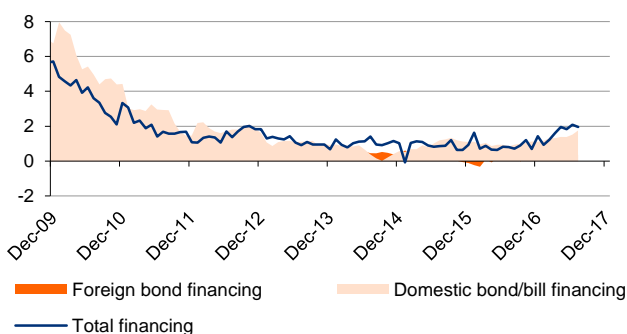
Source: TurkStat, ING estimates

**Fig 11 Real wages growth (%)**



Source: TurkStat, BRSA, ING estimates

**Fig 12 Central gov't borrowing (annual; % of GDP)**



Source: Treasury, ING estimates

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