Economics
11 March 2016

MonitorING Turkey

Tourism getting hit

Turkey has witnessed significant external rebalancing, attributable mainly to cyclical factors such as lower energy prices. This year, these factors should remain in place, though escalation in security concerns and the Russian government's actions, with a likely impact on tourism revenue, should limit improvement in the current account deficit, given the high contribution by tourism revenue. Initial data suggests that total tourist arrivals dropped by 6.4% in January, while gross tourism revenue fell by 16%. If geopolitical risks and security concerns further escalate, with continued slowdown in the tourism sector, economic performance might be weaker than envisaged earlier.

Key points

- The capital flow outlook is more supportive for EMs including Turkey, than was envisaged earlier, given the supportive stance of global central banks. Therefore, TRY should perform well in the near term, though may start weakening again at a relatively faster pace in 2H16, as ING expects the next Fed rate hike in Sep. We still envisage USD/TRY reaching 3.20 by end-2016, although the yearly average should be lower.

- Better global liquidity conditions and a more back-loaded depreciation trend in the currency should provide room for CBT to further delay policy simplification. Now, we forecast the one-week repo rate at 8.5% in 2016 and to reach 10.5% in 2017.

Strategy

FX: We think ongoing TRY strength will not last long, given geopolitical risks and sensitivity to local politics. Elevated headline inflation moving closer to double-digits and pushing real rates to comparably lower levels and a delay in CBT policy simplification are other factors weighing on TRY in times of 'risk-off' mode.

Local debt: We have witnessed a relief rally in the bond market since mid-February, also supported by attractive valuation. However, given still-high inflation, continuing monetary policy uncertainty and ongoing geopolitical risks, we expect the rally to be limited.

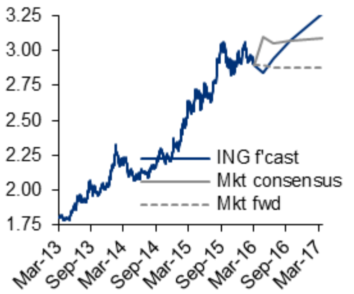
External debt: USD-denominated Turkish debt has returned a decent 2.2% YTD, but has underperformed versus those of global USD emerging markets, which are running at 3.6% YTD, bolstered by an impressive performance in the past few months. There is still room for better performance, as the 2015 sell-off continues to reverse. In terms of relative value, we see the new USD 26s as trading a tad richer to the curve and we like the 75bp+ pickup to the ultra-longs, preferring the 40s and surroundings, which trade at mild pickups versus USD Russia. On the EUR curve, we see the 23s as trading cheap, and they can be swapped into USD for a near 50bp pickup versus the USD 23s.

Quarterly forecasts

	3Q15	4Q15	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F	2Q17F
Real GDP (%YoY)	4.0	4.2	3.0	3.4	3.4	3.8	3.9	4.0
CPI (%YoY) eop	7.9	8.8	8.2	8.1	8.1	8.1	7.7	7.5
Policy interest rate (%) eop	7.50	7.50	7.50	7.50	8.00	8.50	9.00	9.50
3-month interest rate (%) eop	12.18	11.75	11.39	11.14	11.10	11.10	11.13	11.17
10-year yield (%) eop	11.03	10.74	10.10	10.04	10.35	10.60	11.19	11.84
Exchange rate (USDTRY) eop	3.03	2.92	2.85	2.95	3.07	3.20	3.26	3.33
Exchange rate (EURTRY) eop	3.38	3.17	3.08	3.09	3.22	3.52	3.65	3.83

Source: Macrobond, ING estimates

USD/TRY

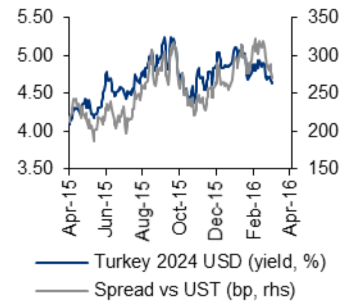


Source: Macrobond, ING estimates

Local 10Y yields

Source: Macrobond, ING estimates

US$ Eurobond 10Y



Source: Bloomberg, Reuters

Latest indicator surprises

Output	Positive
Consumption	Neutral
Inflation	Lower
External	Positive
Budget	Neutral

Source: Bloomberg

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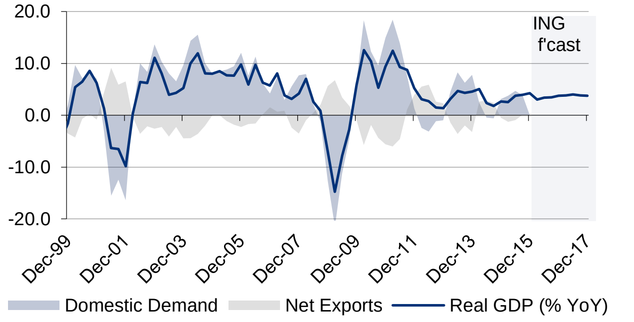
Fig 1 Real GDP (%YoY) and contributions (ppt)

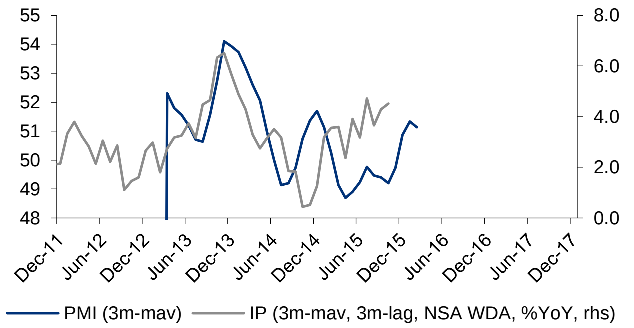


Source: Macrobond, ING estimates

Growth to remain in excess of peer countries

- In the first nine months of 2015, growth performance was better than expectations despite a challenging domestic and global backdrop, given political uncertainty, geopolitical risks and declining capital flows. IP hints at a growth of c.4.0% in 4Q15, which should help register a performance above 3.5% in 2015.
- Dedicated implementation of the reform programme should support the long-term growth outlook, although we think 4.5% GDP growth in the revised MTP is quite optimistic. Given the supportive impact of the 30% minimum wage hike, we expect the Turkish economy to grow more than 3% in 2016, though the capital flow outlook and tension with Russia are drags, with supply-side indicators having recently weakened.

Fig 2 IP vs PMI

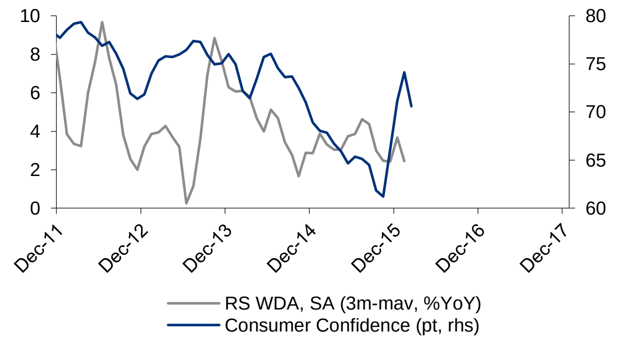


Source: Macrobond, ING estimates

Strong IP performance in January

- The IP index (calendar-adjusted) recorded a 5.6% YoY increase in January, higher than market consensus, while expanding by 1.0% on a sequential basis, the highest since August. Sector-wise, manufacturing production rose healthily and determined the monthly performance for the most part, while negative readings in mining and quarrying and utilities dragged down the headline.
- Among broad economic categories, two heavy-weight groups: non-durable consumer goods and intermediate groups, contributed to better-than-expected monthly performance, with 4.34% and 0.88% MoM increases, respectively. Production in the remaining three groups turned negative, from relatively better readings in December.

Fig 3 Retail sales vs consumer confidence

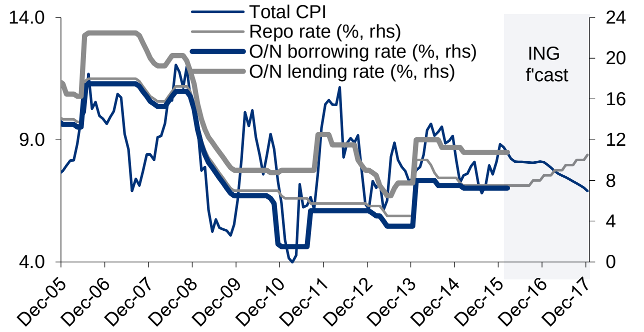


Source: Macrobond, ING estimates

Consumer confidence deteriorating again

- In 3Q15, we observed a significant drop in consumer confidence, reaching its lowest realised value in more than six years, due to volatility in financial markets, geopolitical risks and domestic politics. After a sharp recovery in Nov, with improvement in political risk premium following the elections, consumer confidence started deteriorating again since Dec, amounting to 14% on a cumulative basis.
- Normally, there is a close link between currency strength and consumer confidence, though it has weakened lately, as the sharp re-pricing of the global and US monetary policy outlook is working in favour of the TRY, but with escalating geopolitical tensions in the region weighing on consumer confidence.

Fig 4 CPI vs policy rate

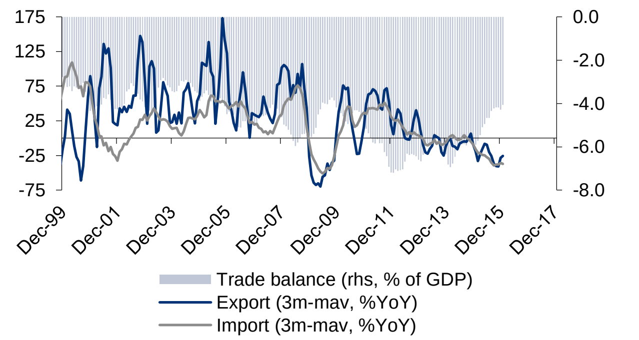


Source: Macrobond, ING estimates

Inflation surprises on the downside

- CPI remained flat in Feb, much better than consensus of 0.33%, pulling annual inflation down from 9.6% to 8.8%, helped by a downtrend in food prices and supportive base effects. Core H&I indicators further increased annually, hinting that cost factors weigh on the core inflation trend, despite benign energy prices.
- Overall, annual inflation dropped significantly from its highest level recorded in May-14. However, it has remained above the target band since 2011, and as a sign of a credibility gap, 12M and 24M forecasts started increasing again since the beginning of this year, at 7.96% and 7.29%, respectively, above the upper band of the bank's target range.

Fig 5 Trade balance, 3M (%GDP)

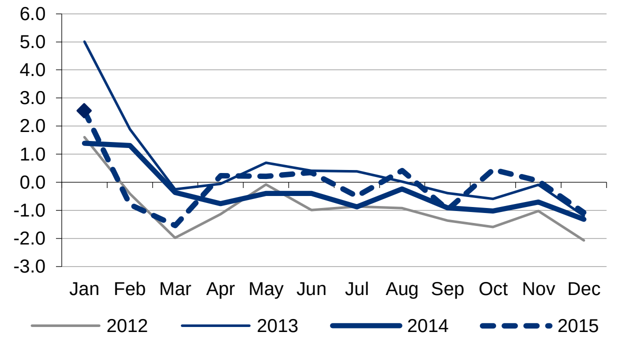


Source: Macrobond, ING estimates

12M rolling trade deficit at the lowest since Sep-10

- The foreign trade deficit came in at USD3.8bn in Jan, pulling the annual figure down to USD62.7bn, the lowest level since Sep-10. The data shows that external rebalancing remains intact, given the support of lower oil prices and despite exports being hit by lower demand from major oil exporters and a drop in gold trade. Coverage of imports by exports last year slightly declined to 69.2% from 69.4% a month ago, the highest reading for close to five years.
- Exports to the MENA region remained weak, with a drop in share from 27.4% to 26.0% and maintained a downtrend since 2012. The share of exports to the EU recorded a marked gain, reaching 49.5% in Jan-16, versus 42.7% in the same period in 2015.

Fig 6 Budget performance YTD (% GDP)

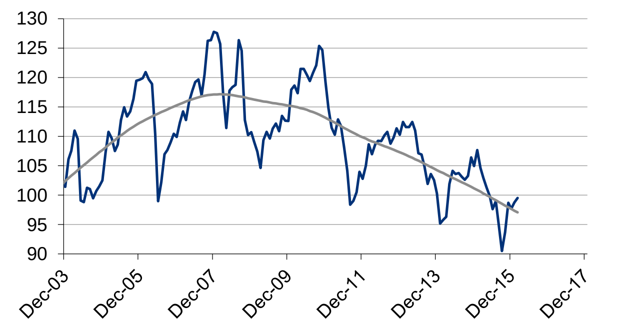


Source: Macrobond, ING estimates

Double-digit growth in Jan budget surplus

- The central administration budget recorded a TL4.2bn surplus in Jan-16, up by 11% YoY, while the primary surplus realised was TL9.8bn, increasing 12% over Jan-15. For 2016, the government looks for a TL29.7bn budget deficit (-1.3% of GDP) and TL26.3bn primary surplus (1.2% of GDP).
- Revenue grew by 16.5% YoY, attributable to a healthy tax generation, up by 13.8% YoY. As the major driver of revenue, tax income growth stemmed from income tax (3.0ppt), domestic VAT (2.2ppt) and special consumption tax (5.5ppt). On the spending side, primary expenditure was strong, with a 17.8% rise, driven by all items, with the exception of capital expenditure.

Fig 7 FX: REER vs trend (index)



Source: Macrobond, ING estimates

CBT remained silent in Feb

- The CBT kept the policy rate at 7.50%, and O/N borrowing and lending rates at 7.25% and 10.75%, respectively.
- The CBT is likely to maintain the current policy framework until there is a sustainable decline in global volatility or it is sure that policy tools specified in the August roadmap can permanently cap the effects of volatility. This means that the CBT is due to maintain the status quo for an unspecified time, given that volatility is hard to predict and being largely driven by changes in risk sentiment. Once the simplification starts by narrowing the corridor and making it more symmetrical around the one-week repo rate, the policy framework should be less complex and more predictable.

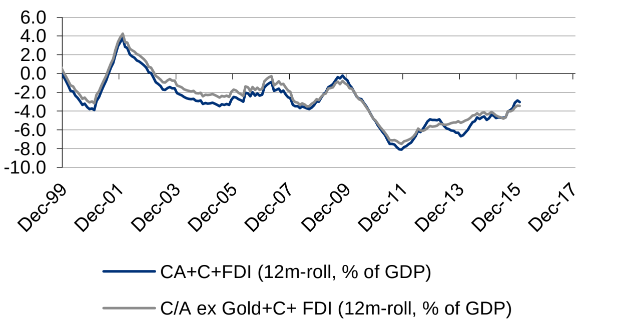
Fig 8 Main recent macroeconomic releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilisation (%)	Dec	75.8	Jan	74.9	Feb	73.5	-	74.5
Industrial Confidence	Dec	102.2	Jan	103.3	Feb	104.5		-
Industrial Production (SA WDA, MoM%)	Nov	-0.8	Dec	0.8	Jan	1.0	+	-0.9
Industrial Production (WDA, YoY%)	Nov	3.6	Dec	4.62	Jan	5.6	+	4.0
Consumer Confidence	Dec	73.58	Jan	71.62	Feb	66.6	-	71.2
Unemployment Rate (%)	Sep	10.3	Oct	10.5	Nov	10.5	-	10.8
GDP (SA WDA, QoQ%)	1Q	1.5	2Q	1.4	3Q	1.3	+	0.4
GDP (YoY%)	1Q	2.5	2Q	3.8	3Q	4.0	+	2.7
GDP (WDA, YoY%)	1Q	2.6	2Q	3.8	3Q	5.4	+	3.3
Core CPI (YoY%)	Dec	9.5	Jan	9.6	Feb	9.7	+	9.7
CPI (YoY%)	Dec	8.8	Jan	9.6	Feb	8.8	-	9.4
PPI (YoY%)	Dec	5.7	Jan	5.9	Feb	4.5	-	5.7
1W Repo Rate announcement (%)	Dec	7.50	Jan	7.50	Feb	7.50		7.50
Overnight Borrowing Rate announcement (%)	Dec	7.25	Jan	7.25	Feb	7.25		7.25
Overnight Lending Rate announcement (%)	Dec	10.75	Jan	10.75	Feb	10.75		10.75
Trade Balance (US$bn)	Nov	-4.3	Dec	-6.2	Jan	-3.8	+	-3.8
Current Account (US$bn)	Nov	-2.2	Dec	-5.0	Jan	-2.2	+	-2.4

Source: Bloomberg

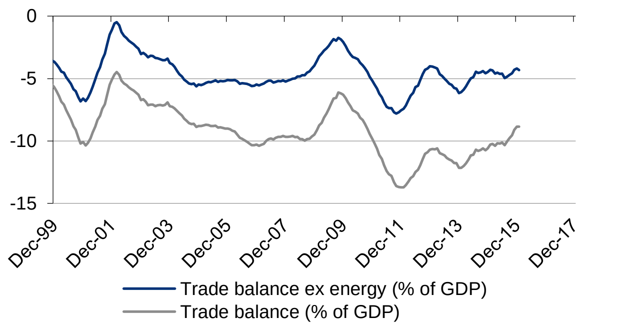
Additional charts

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



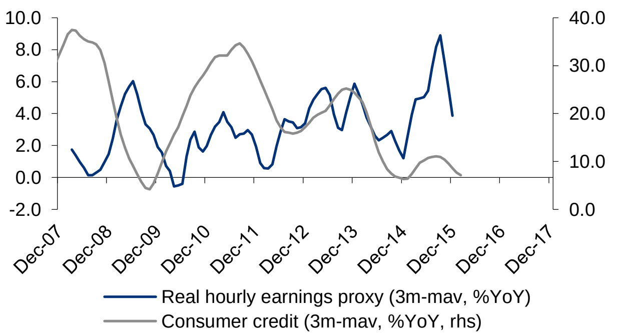
Source: Macrobond, ING estimates

Fig 10 Trade balance (annual; % of GDP)



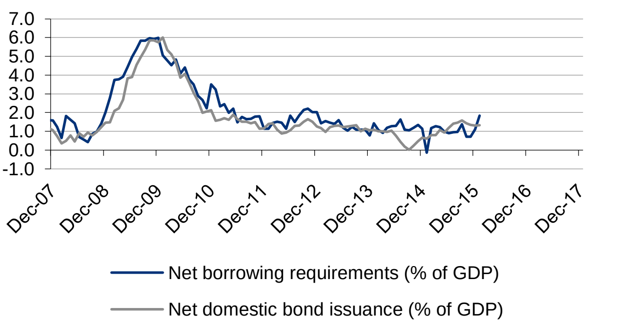
Source: Macrobond, ING estimates

Fig 11 Real wages growth (%)



Source: Macrobond, ING estimates

Fig 12 Govt central borrowing requirements (annual)



Source: Macrobond, ING estimates

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