Emerging Markets
11 July 2016

MonitorING Turkey

No immediate impact of Brexit

Lower rates and TRY strength, retracing recent losses, reflect fading Brexit worries, with no immediate effect for Turkey in the short term. However, in the longer term, we may see a loss of momentum in trade with the UK, given any new deal is unlikely to be as favourable as the current Customs Union, while a negative growth shock to the EU might also weigh on Turkey's macro performance.

- Given ING's bearish scenario for oil (average USD40/bbl over 2016-17), following Brexit, we make a consequent adjustment to the external deficit forecast, with a c/a deficit-to-GDP ratio of 4.7% in 2016 and 4.5% in 2017. Warming of relations with Russia will also be supportive, though recovery to pre-crisis levels in tourism revenue may take time.
- With a higher-than-expected June reading due to the Ramadan impact causing a correction in food prices, we mechanically revise our year-end forecast from 7.5% to 7.7%.
- This month, we see more room for the CBT to continue its easing cycle (cutting the upper lending rate potentially by another 50bp), given EM assets are nearly back to levels before the Brexit issue, which is also the market expectation (currently pricing a 100bp cut).

The release of the third inflation report of the year towards the month-end is due to give more clues on the CBT's inflation outlook, while the July MPC will provide clarification on whether the bank will maintain the ongoing easing cycle and when the simplification process will be finalised.

FX and money markets: Despite the likely negative growth shock from Brexit to the UK and the Euro area, the dovish re-pricing of global monetary policy, with lower-for-longer developed market yields, stabilises sentiment and induces a search for yield. This may briefly support USD/TRY, with a move to 2.80. However, Turkey's idiosyncratic risks continue to be an additional source of volatility.

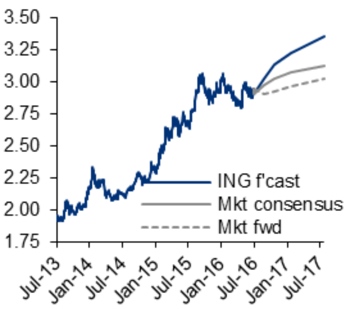
Domestic debt and rates: The market now focuses on the prospects of a looser global monetary policy for longer. Consequently, long TURKGBs and TRY cross-currency swap rates receivers look attractive, particularly if the stabilisation in risk appetite and the potential TRY rebound delivers another 50bp cut in the CBT's upper lending rate.

Quarterly forecasts

	1Q16	2Q16	3Q16F	4Q16F	1Q17F	2Q17F	3Q17F	4Q17F
Real GDP (%YoY)	4.8	3.3	3.1	4.2	3.5	3.9	3.7	3.9
CPI (%YoY) eop	7.5	7.6	7.2	7.7	7.9	7.4	7.5	7.2
Central bank key rate (%) eop	7.50	7.50	7.50	7.50	7.50	8.00	8.00	8.50
3m interest rate (%) eop	11.07	9.50	9.90	9.80	9.93	10.06	10.19	10.32
10yr yield (%) eop	9.95	9.22	9.93	10.12	9.35	11.86	11.31	11.59
Exchange rate (USD/TRY) eop	2.82	2.88	3.09	3.20	3.26	3.33	3.39	3.45
Exchange rate (EUR/TRY) eop	3.20	3.16	3.33	3.52	3.65	3.83	4.00	4.14

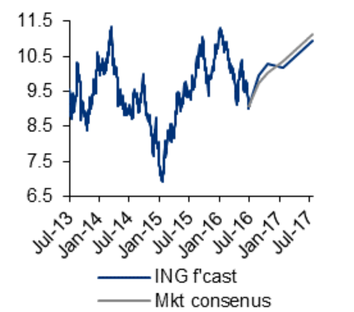
Source: Macrobond, ING estimates

USD/TRY



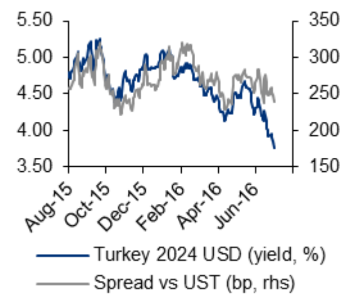
Source: Macrobond, ING estimates

Local 10Y yields



Source: Macrobond, ING estimates

US$ Eurobond 10Y



Source: Bloomberg, Reuters

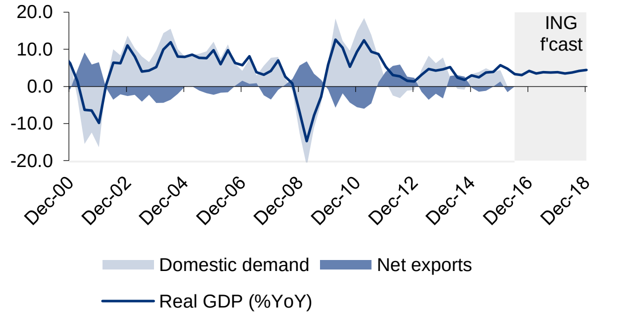
Latest indicator surprises

Output	Negative
Consumption	Positive
Inflation	Neutral
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)

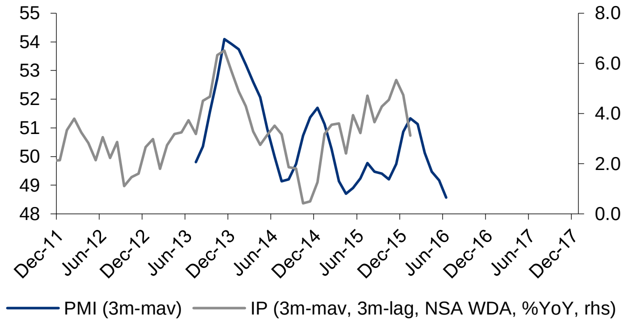


Source: Macrobond, ING estimates

Easier policies support consumption demand

- Private demand continues to be the major factor of relatively buoyant growth, despite weak investment appetite due to political risks and lower credit impulse. In particular, relaxing macroeconomic policies, with a 30% increase in the minimum wage at the beginning of this year and the CBT's supportive stance of lowering the O/N lending rate four times since February, by a cumulative 175bp to 9%, supports domestic demand.
- Real GDP growth is likely to slow to 3.8% this year, down from 4% in 2015, while ongoing political risks likely weigh on the growth performance. This is despite easing geopolitical pressure, with Turkey's increasing efforts to improve relations with Russia.

Fig 2 IP vs PMI

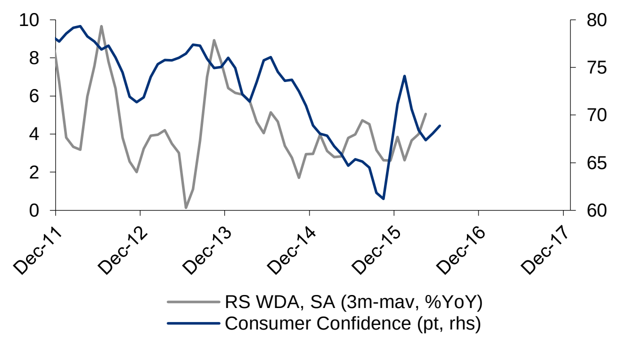


Source: Macrobond, ING estimates

Momentum loss in activity

- April IP grew by a mere 0.7% YoY, below Reuters consensus, translating into a 1.1% contraction in sequential terms, the largest drop since July 2015. Remaining resilient in 1Q, volatile IP (SA) has markedly decelerated in the first month of 2Q. Not only IP data, but other indicators highlight the weakness: PMI still in contraction territory and stagnant business confidence.
- The PMI, which remained in expansionary territory in the first two months of 2016, dropped below the 50-point threshold again, though it slightly recovered in May, from 48.90 to 49.40. This suggests a bounce in IP, along with the contribution of favourable base effects, given the impact of strikes in automotive manufacturing last year.

Fig 3 Retail sales vs consumer confidence

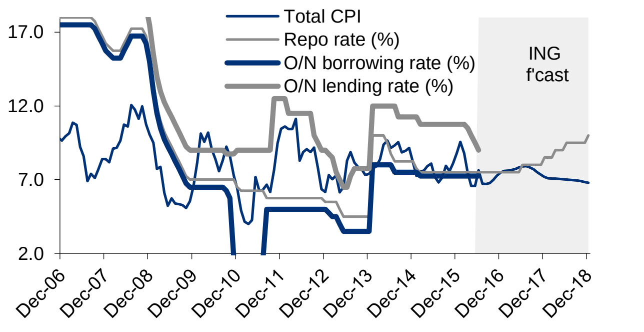


Source: Macrobond, ING estimates

Slowing consumer demand in 2Q

- Volume of retail sales (cal adj.) was up by 3.4% YoY in April, while seasonally adj. retail turnover turned out to be -0.1%. The YTD increase in volume of retail sales came in at 3.8%, just above last year's 3.6% average growth. Production of consumer goods weakened in April, while sales of white goods, which recorded strong growth rates in 1Q, weakened markedly in 2Q. On the other hand, sales of automobile and light commercial vehicles, which contracted until April owing to the strong base effects, remained on the rise in volume terms and were up by 15.2% YoY in May.
- In all, data on the spending side paints a mixed picture, with signals of a slowdown in consumer demand lately.

Fig 4 CPI vs policy rate

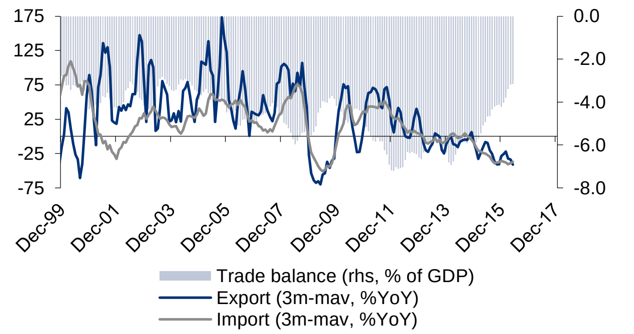


Source: Macrobond, ING estimates

Annual inflation exceeding target range again

- The CPI rose by 0.47% in June, above market consensus and our call at 0.1%, pushing annual inflation sharply up to 7.64%, from 6.58% a month ago. The Domestic Producer Price Index (D-PPI) recorded a 0.41% increase, while annual inflation recorded a bounce back to 3.41%.
- Following a strong downward adjustment in recent months, food inflation, which saw a correction in June due to the Ramadan impact, turned out to be the main driver of the monthly reading. On the other hand, supported by strong base effects in the exchange rate pass through last year and recent TRY stability, annual inflation in core indicators continued to improve.

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

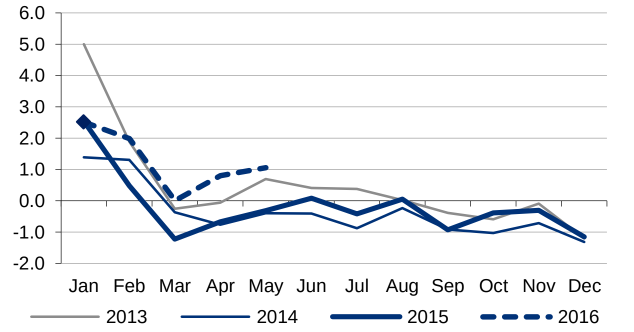


Source: Macrobond, ING estimates

The trade deficit maintained its improving trend

- The trade balance came in at USD5.1bn in May and pulled the 12M rolling deficit down to USD57.7bn, the lowest in almost six years. The improvement, once again, is due to lower energy prices, while the core deficit was practically unchanged.
- Intermediate goods have been the major driver of contraction in imports, down by 6.2% YoY, followed by a 1.0% YoY drop in capital goods, while consumer goods recorded a 4.2% YoY increase. Exports to the MENA region maintained a downtrend, due to lower demand from major oil producers and geopolitical risks, with a drop in share from 30.3% to 28.5%. The share of exports to the EU recorded a marked gain, standing at 48.5%.

Fig 6 Budget performance YTD (% of GDP)

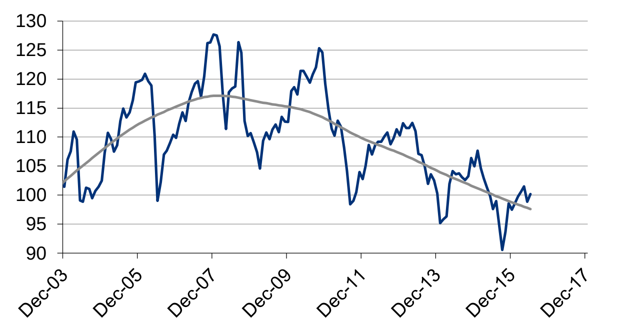


Source: Macrobond, ING estimates

Budget performance remains firm

- The central administration budget balance recorded a strong TRY3.7bn surplus in May, vs a TRY+1.6bn reading in the same month last year, due to sizeable revenue generation (18.7% YoY). However, primary spending maintained its uptrend with 12.5% YoY growth, though with a momentum loss, and saw a jump in interest expenditure by 30.9% YoY, on the back of the uneven payment structure of Treasury debt.
- On a cumulative basis, the budget balance turned into a surplus, with TRY9.1bn in the first five months of the year, vs TRY-2.4bn in the same period of 2015, while the primary surplus surged by 30% YoY to TRY33.3bn, well above the current year-end target..

Fig 7 FX: REER vs trend (index, ppt)



Source: Macrobond, ING estimates

The CBT cut the O/N lending rate again

- The CBT continued the easing cycle in June, with a 50bp cut from the upper band to 9.0%. Despite the revival of volatility in financial markets, the CBT stuck to the simplification process.
- The decision reflects the improvement in core inflation indicators, a more dovish Fed and the still resilient TRY in real terms, despite ongoing Brexit fears. The move was in line with statements from Economy Minister Nihat Zeybekci on the pace of cuts (a 50bp reduction at each meeting seen as appropriate). Given that the spread between the effective funding rate and off-shore rate is expected to continue to remain relatively wide (more than 50bp), further cut(s) in the O/N lending rate, towards 8.5%, might be on the agenda.

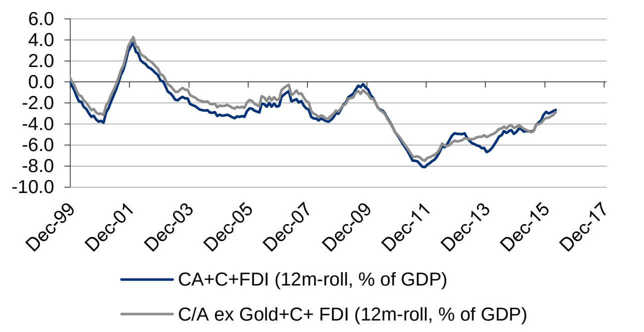
Fig 8 Main recent macroeconomic releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilisation (%)	Apr	75.3	May	75.7	Jun	76.1		-
Industrial Confidence	Apr	110.1	May	109.8	Jun	106.8		-
Industrial Production (SA WDA, MoM%)	Feb	0.5	Mar	-0.5	Apr	-1.2	-	0.1
Industrial Production (WDA, YoY%)	Feb	5.9	Mar	3	Apr	0.7	-	3.1
Consumer Confidence	Apr	68.46	May	68.75	Jun	69.4		-
Unemployment Rate (%)	Jan	11.1	Feb	10.9	Mar	10.1	-	10.4
GDP (SA WDA, QoQ%)	Q3	1.1	Q4	1.2	Q1	0.8	+	0.6
GDP (YoY%)	Q3	3.9	Q4	5.7	Q1	4.8	+	4.4
GDP (WDA, YoY%)	Q3	5.0	Q4	4.6	Q1	4.5	+	4.2
Core CPI (YoY%)	Apr	9.4	May	8.8	Jun	8.7	-	8.9
CPI (YoY%)	Apr	6.6	May	6.6	Jun	7.6	+	6.9
PPI (YoY%)	Apr	2.9	May	3.3	Jun	3.4		-
1W Repo Rate announcement (%)	Apr	7.50	May	7.50	Jun	7.50		7.50
Overnight Borrowing Rate announcement (%)	Apr	7.25	May	7.25	Jun	7.25		7.25
Overnight Lending Rate announcement (%)	Apr	10.00	May	9.50	Jun	9.00		9.00
Trade Balance (US$bn)	Mar	-5.0	Apr	-4.2	May	-5.1	+	-5.1
Current Account (US$bn)	Feb	-1.9	Mar	-3.7	Apr	-3.0	+	-3.4

Source: Bloomberg

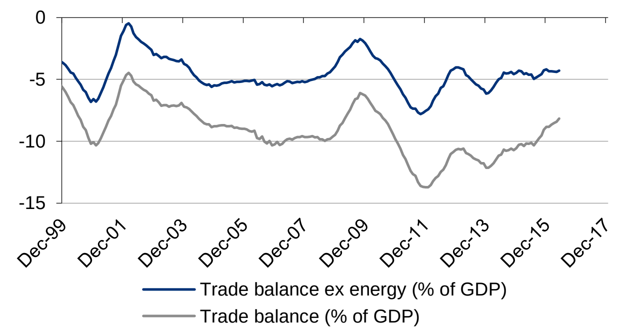
Additional charts

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



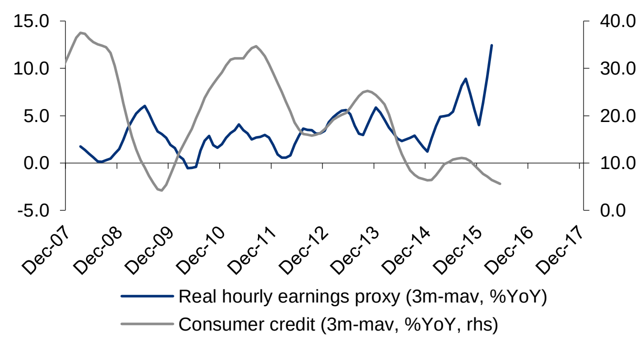
Source: Macrobond, ING estimates

Fig 10 Trade balance (annual; % of GDP)



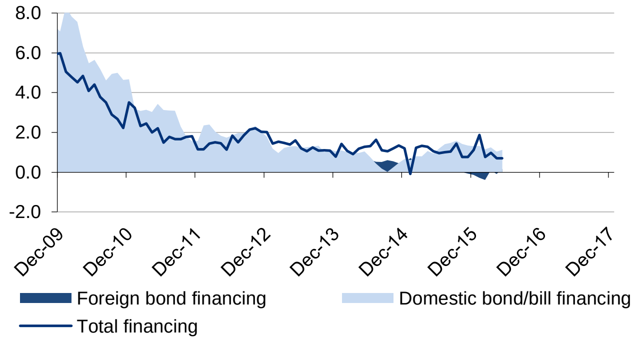
Source: Macrobond, ING estimates

Fig 11 Real wages growth (%)



Source: Macrobond, ING estimates

Fig 12 Central govt borrowing (annual; % of GDP)



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: