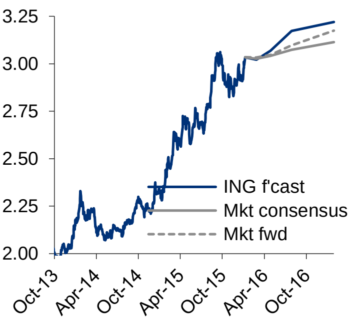
Economics
13 January 2016

MonitorING Turkey

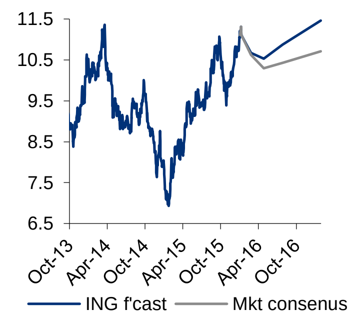
Another CBT surprise?

USD/TRY



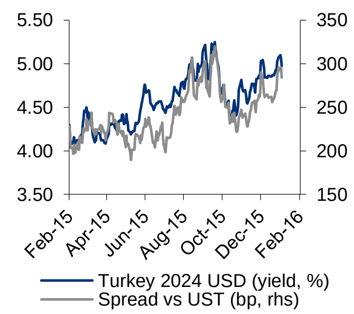
Source: Macrobond, ING estimates

Local 10Y yields



Source: Macrobond, ING estimates

US$ Eurobond 10Y



Source: Bloomberg, Reuters

Latest indicator surprises

Output	Negative
Consumption	Positive
Inflation	Higher
External	Negative
Budget	Neutral

Source: Bloomberg

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Contrary to consensus expectations that the CBT is to start its simplification process in the wake of the Fed normalisation, the bank left all rates unchanged for the tenth consecutive month in December, despite previous policy guidance. The CBT did add a new sentence to the MPC statement and signalled that the policy simplification could start in January, "should the decline in volatility observed after the start of the global policy normalization persist". We think that the CBT delayed the policy simplification by one month, probably with the rationale of starting the process when the markets open after the holiday season. Thus, we do not see any change in the short-term monetary policy outlook and continue to expect the policy move this month. However, volatility indicators that the CBT explicitly refers to in its communication have deteriorated recently, making another under-delivery possible that could hurt the bank's credibility further, with a negative market reaction.

Key points:

- In addition to the cost-push impact from the minimum wage hike, the government announced tax hikes on some products, while increasing electricity prices and tolls & bridge fares, with an additional 0.5-0.7ppt impact on 2016 headline inflation. Accordingly, we revise our forecast from 7.5% to 8.0%. The current problematic inflation outlook indicates a challenging year for the CBT on the price stability front.
- Improving signals from recent indicators and the minimum wage hike impel us to revise the 2016F GDP growth forecast from 3.0% to 3.4%.

The main focus over the month ahead is on the January MPC and the release of the first inflation report of the year.

Strategy:

FX: TRY started this year with a significant weakening due to waning global risk appetite, with additional pressure from local drivers like the CBT remaining 'on hold' despite the Fed's lift-off and elevated inflation. We think that country-specific factors such as external imbalances, foreign funding requirements, high currency risk carried by the corporate sector, likely political noise and geopolitical risks will pressure the TRY in 2016.

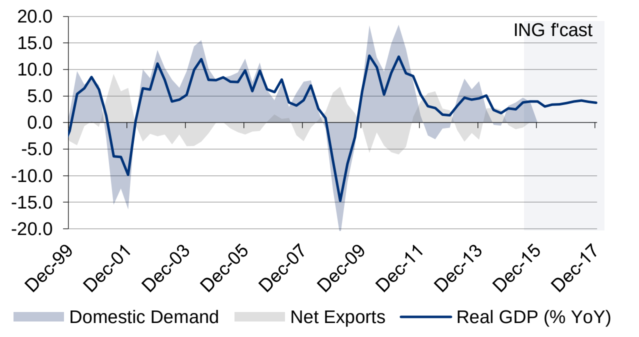
Local debt: Bond yields are also suffering from negative global sentiment, owing in part to disappointing performance on the inflation front, closing the year at a high-single-digit level, and other idiosyncratic factors. Accordingly, 2Y yields have jumped 33bp and 10Y yields 56bp since end-2015. We expect yields to remain elevated, given the difficult macro and political environment and challenging external funding conditions.

Quarterly forecasts

	3Q15	4Q15	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F	2Q17F
Real GDP (%YoY)	4.0	4.0	3.0	3.4	3.4	3.7	4.0	4.1
CPI (%YoY) eop	7.9	8.8	8.6	8.5	8.4	8.2	7.6	7.3
Policy interest rate (%) eop	7.50	7.50	8.50	9.00	9.00	9.50	10.00	10.50
3-month interest rate (%) eop	11.89	11.47	11.06	11.01	11.00	11.00	10.63	10.77
10-year yield (%) eop	11.03	10.74	10.48	10.86	10.76	11.21	11.92	12.41
Exchange rate (USDTRY) eop	3.02	2.92	3.03	3.15	3.17	3.20	3.26	3.33
Exchange rate (EURTRY) eop	3.38	3.06	3.09	3.09	3.17	3.26	3.39	3.53

Source: EcoWin, ING estimates

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

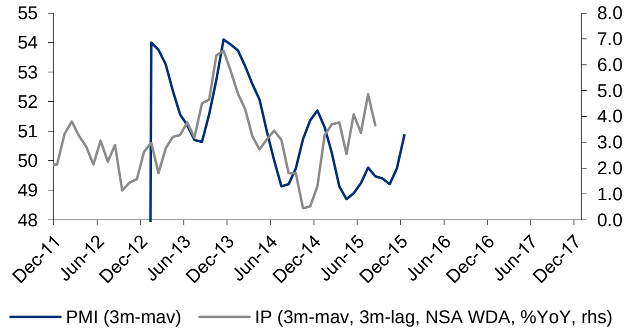


Source: Macrobond, ING estimates

The Turkish economy remains resilient

- Despite significant TL weakness, the extended election cycle and growing geopolitical risks, the Turkish economy has remained resilient, with GDP growth in 2015 generally surprising to the upside.
- Recent indicators hint at further recovery in activity, given the December PMI improving to the highest level in a year, better consumer sentiment and business tendency and some signs of acceleration in corporate lending. This momentum and the minimum wage hike provide upside risks to growth. However, vulnerability to volatility in global financial markets, the repercussions of Fed normalisation and escalating regional and international political tensions indicate downside risks to the growth outlook.

Fig 2 IP versus PMI

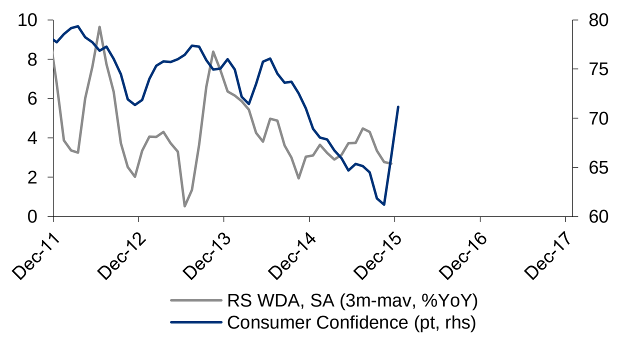


Source: Macrobond, ING estimates

Sequential IP growth negative in November

- Seasonal and calendar-adjusted IP in November contracted by 0.9% on a sequential basis.
- Among broad economic categories, production in all groups, with the exception of non-durable consumer goods, turned negative. Despite a drop in December, a significant recovery in consumer confidence in recent months signals an improvement in private consumption, implying a relatively strong contribution from this source to 4Q GDP growth. Meanwhile, improving business confidence in recent months hints at further recovery in investment appetite, though contribution to growth performance in the previous quarter is likely limited.

Fig 3 Retail sales versus consumer confidence

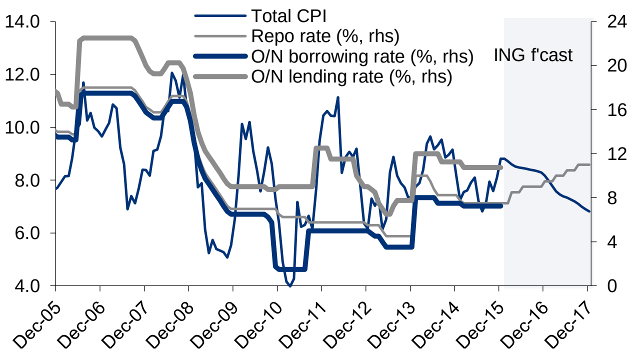


Source: Macrobond, ING estimates

Unemployment (SA) flat in recent months

- Labour participation (SA) hit an all-time high of 51.6% in September, vs 50.9% at end-2014. Despite a significant increase in participation, unemployment (SA) remained unchanged vs the last month of 2014 at 10.4%, after recording single digits in April. This is attributable to strong job creation on a YTD basis of 662k (in SA terms). Non-agricultural sectors emerged the major contributors with 536k jobs driven by services (472k) and industry (61k), while agriculture also created a substantial 125k new jobs.
- In all, the economy seemed to quicken its pace of job creation, though lower growth and the Syrian refugee crisis are major issues weighing on the labour market.

Fig 4 CPI versus policy rate

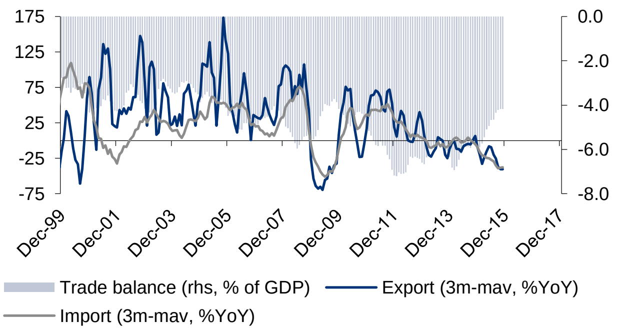


Source: Macrobond, ING estimates

Continuing problematic inflation outlook

- CPI rose 0.21% in December, pulling annual CPI down markedly from 8.10% to 8.81%, assisted by negative base effects.
- Despite supportive energy prices, pressure on the inflation outlook continues, as the annual figure closed at a high level. Going forward, movements in the currency market should determine the annual inflation trajectory, along with commodity and food prices that might continue to be a source of concern, given extreme winter conditions. Additionally, headline inflation may still be under pressure, with the 30% hike in minimum wage and electricity price hike announced at the beginning of 2016.

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

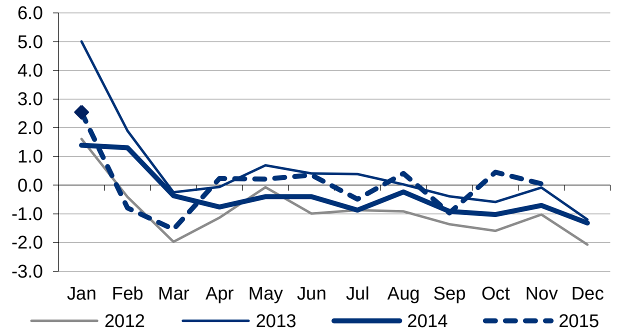


Source: Macrobond, ING estimates

Foreign trade deficit continues narrowing fast

- Turkey posted a foreign trade deficit of just USD4.2bn in November, vs USD8.3bn in the same month of 2014. As a result, the 12M rolling deficit fell from USD69.6bn in October to a five-year low of USD65.5bn in November. Preliminary foreign trade data showed that the deficit is likely to narrow even more sharply in December.
- The data provides evidence that external rebalancing has been narrowing at a faster pace since August. We think the improving trend remains attributable to increased price competitiveness, slow recovery in domestic demand and the downtrend in energy prices. Economic sanctions introduced by Russia on fruit and vegetable imports are likely to limit the extent of improvement.

Fig 6 Budget performance YTD (% of GDP)

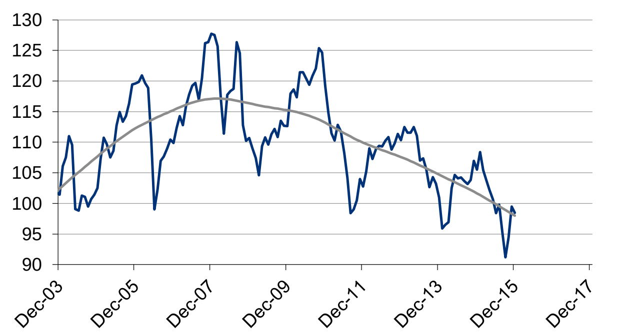


Source: Macrobond, ING estimates

Budget deficit halved in the first eleven months

- The budget deficit more than halved, standing at TRY-5.4bn for January-November 2015, vs TRY-11.3bn in the same period of 2014, while the primary surplus expanded by almost a quarter to TRY45.8bn, well above the year-end target. The government also passed the temporary budget bill in parliament, to be valid only for 1Q16.
- The 30% hike in minimum wage was approved, while the government agreed to cover TRY110 per worker, translating into more than 35% of the incremental burden. This move will cost TRY9.7bn (0.4% of GDP), out of TRY22bn (c.1% of GDP) expenditure related to election promises.

Fig 7 FX: REER versus trend (index)



Source: Macrobond, ING estimates

Further loss of FX reserves

- TRY REER bounced back by 8% from near the lowest levels seen since 2003 in recent months, attributable to a relatively better risk appetite, supported by improvement in political sentiment with continuity in government and the reduced risk of another early election. However, TRY is still 10% below its long-term average.
- The CBT's net FX position is c.USD28.4bn, down from over USD40bn in mid-Dec 2014. Gross FX reserves have dropped by over USD17bn since Feb 2015 to c.USD93bn at end-2015, due to directly meeting FX needs of energy-importing state-owned companies, direct FX sales, ROC adjustments and significant deceleration in capital inflows.

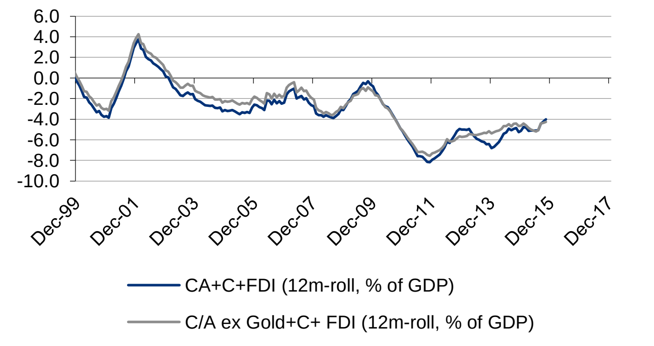
Fig 8 Main recent macroeconomic releases

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilisation (%)	Oct	75.5	Nov	75.9	Dec	75.8		-
Industrial Confidence	Oct	100.5	Nov	105.2	Dec	102.2		-
Industrial Production (SA WDA, MoM%)	Sep	-0.1	Oct	0.2	Nov	-0.9	-	0.0
Industrial Production (WDA, YoY%)	Sep	2.8	Oct	4.66	Nov	3.5	-	4.3
Consumer Confidence	Oct	62.78	Nov	77.15	Dec	73.6		-
Unemployment Rate (%)	Jul	9.8	Aug	10.1	Sep	10.3	-	10.45
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%)	Oct	8.9	Nov	9.2	Dec	9.5	+	9.4
CPI (YoY%)	Oct	7.6	Nov	8.1	Dec	8.8	+	8.5
PPI (YoY%)	Oct	5.7	Nov	5.3	Dec	5.7	-	6.0
1W Repo Rate Announcement (%)	Jul	7.50	Aug	7.50	Dec	7.50	-	8.00
Overnight Borrowing Rate Announcement (%)	Jul	7.25	Aug	7.25	Dec	7.25	-	7.50
Overnight Lending Rate Announcement (%)	Jul	10.75	Aug	10.75	Dec	10.75		10.75
Trade Balance (US$bn)	Sep	-3.8	Oct	-3.7	Nov	-4.2	-	-4.1
Current Account (US$bn)	Sep	0.1	Oct	-0.1	Nov	-2.1	-	-2.0

Source: Bloomberg

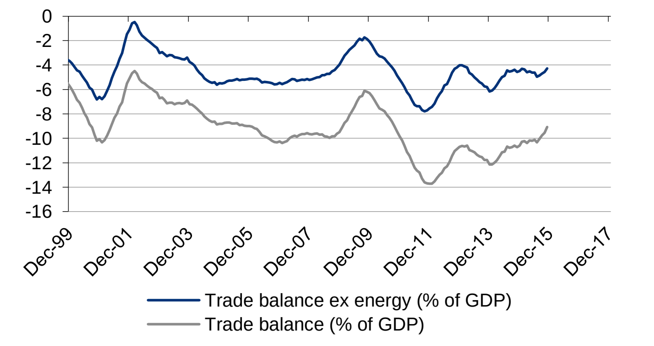
Additional charts

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



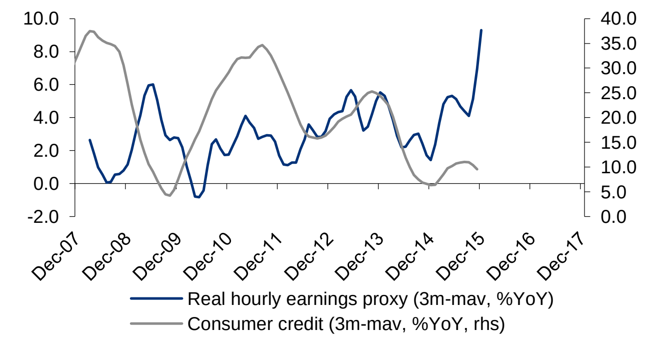
Source: Macrobond, ING estimates

Fig 10 Trade balance (annual)



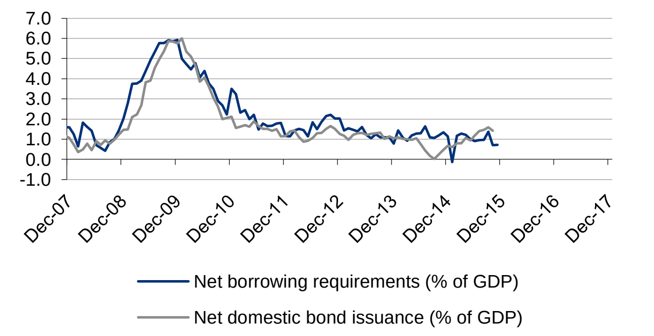
Source: Macrobond, ING estimates

Fig 11 [Title]



Source: Macrobond, ING estimates

Fig 12 Gov't central borrowing requirements (annual)



Source: Macrobond, ING estimates

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