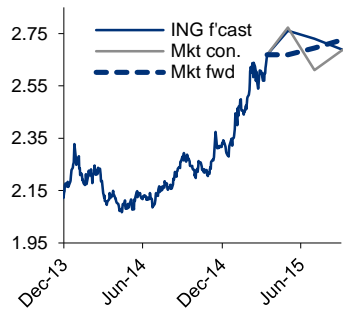


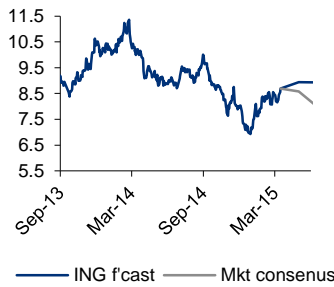
Economics
15 April 2015

USDTRY



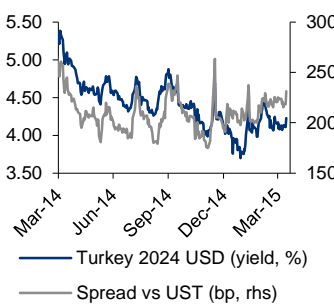
Source: EcoWin, ING estimates

Local 10Y yields (%)



Source: EcoWin, ING estimates

US\$ Eurobond (2024)



Source: Bloomberg

Latest indicator surprises

Output	Neutral
Consumption	Neutral
Inflation	Neutral
External	Negative
Budget	Neutral

Source: Bloomberg

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Downside risks to growth...

Domestic demand became the main driver of GDP growth in 4Q14, along with strong support from stock replenishment. However, in addition to a drop in consumer confidence, retail lending growth continues to be low, implying a weaker growth outlook, exacerbated by a sluggish domestic demand recovery in 1Q15. On the inflation front, the past two months' data releases proved that the disinflation process might be more difficult than anticipated as we saw some pressure on transportation prices due to a weaker TRY, while adverse weather conditions weighed on food prices, pushing up annual inflation.

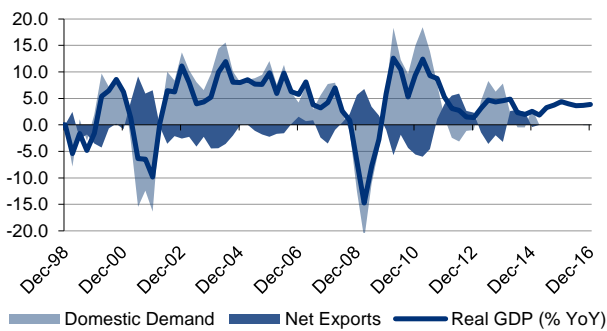
- In 2015, we expect a recovery in private consumption and investment, especially with the end of the election cycle, with falling commodity prices contributing to this performance. However, the latest indicators, ie, : (1) PMI falling for the fourth-consecutive month in March; (2) ongoing weakness in consumer and business confidence, aided by political uncertainty in recent months; and (3) sluggish IP readings imply that economic activity in 1Q15 could be fairly modest, reflecting recent market volatility and political intervention in CBT policies.
- Accordingly, we downgrade our 2015 and 2016 growth estimates to 3.4% and 3.8%, respectively, from 3.9% and 4.0%.
- The main focus in the month ahead will be on the April MPC and the release of the second inflation report of 2015. We expect CBT to remain silent this month.
- **FX:** Since the beginning of February, we have witnessed significant TRY depreciation against the USD and a 50:50 USD:EUR basket. Given that the Turkish markets face near-term political risk and external market conditions continue to be volatile, **we expect the TRY to continue under a weakening bias towards 2.75 in 2015.**
- **Local debt:** The inflation outlook continues to be challenging, with expectations starting to deteriorate again, while the forecast for end-2015 inflation has risen to the upper band of the CBT's uncertainty range. In addition to inflation data, sluggish global risk appetite and local politics also pushed 2Y benchmark bond yields up to close to 9% in March. **Although weaker-than-expected US data has recently provided some support, we expect yields to remain under pressure towards the general elections.**
- **External debt:** The Treasury tapped the Eurobond market and successfully completed a USD1.5bn 10Y issuance. **Given resuming TRY volatility and a rise in CDS premia, we might see a consequent increase in Eurobond yields.**

Quarterly forecasts

	3Q14	4Q14	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F
Real GDP (%YoY)	1.9	2.6	1.8	3.3	3.8	4.4	4.0	3.6
CPI (%YoY) eop	8.9	8.2	7.6	6.3	6.6	6.8	5.8	5.8
Policy interest rate (%) eop	8.25	8.25	7.50	7.50	7.50	7.50	7.50	7.50
3-month interest rate (%) eop	10.69	9.79	10.25	10.25	9.80	9.32	8.98	8.89
10-year yield (%) eop	9.95	7.96	8.36	9.01	8.58	8.36	8.55	8.63
Exchange rate (USD/TRY) eop	2.28	2.33	2.60	2.75	2.69	2.65	2.68	2.70
Exchange rate (EUR/TRY) eop	2.88	2.82	2.79	2.75	2.64	2.52	2.47	2.43

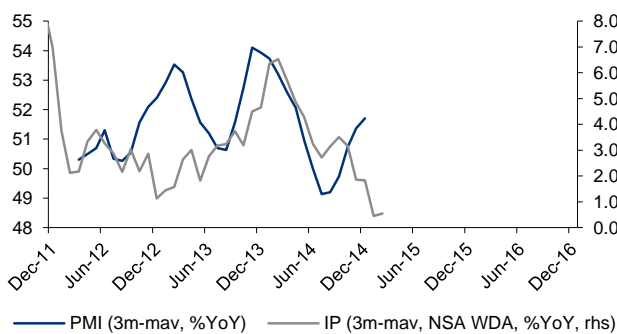
Source: EcoWin, ING estimates

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



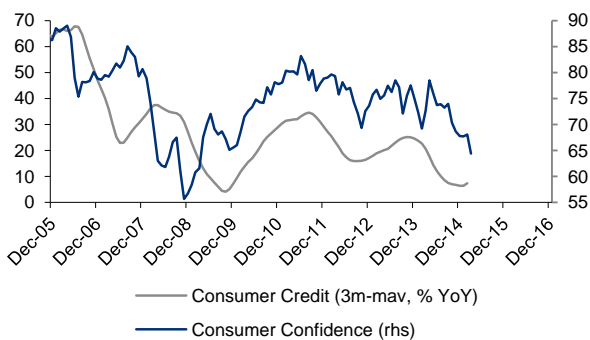
Source: EcoWin, ING estimates

Fig 2 IP versus PMI



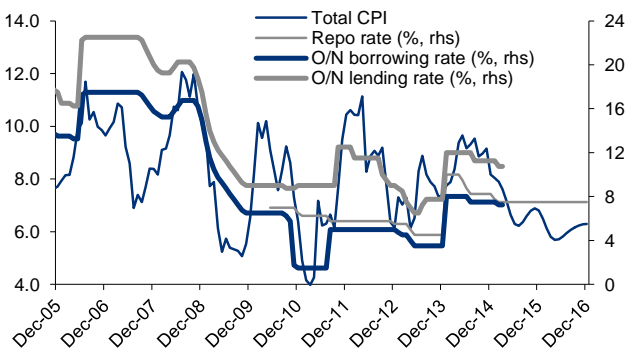
Source: EcoWin, ING estimates

Fig 3 Consumer confidence versus credit



Source: EcoWin, ING estimates

Fig 4 CPI versus policy rate



Source: EcoWin, ING estimates

Upside surprise in 4Q14 growth

- Following a weak performance in 3Q, economic activity was better than expected in 4Q, with 2.6% YoY growth. Accordingly, annual GDP growth was 2.9%, lower than the government's 3.3% projection for 2014, according to the Medium-Term Programme for 2015-17.
- Domestic demand became the main driver of GDP growth in 4Q, along with strong support from stock replenishment, while the contribution from net exports was negative for the first time since 4Q13.
- We expect a further recovery in private consumption and investment, especially with the end of the election cycle.

Volatile IP up 1% in February

- Following a weak start to the year with a 2.1% drop in January, IP expanded by 1.0% YoY in February, better than market consensus at -0.45%, translating into a sharp 1.7% MoM increase in seasonally adjusted (SA) indicators.
- Motor vehicle production was, again, the major contributor, followed by other transport equipment, dominated by defence industry products and pharmaceuticals. On the flip side, textile and non-metallic mineral products dragged down IP.
- Overall, given the volatile nature of industrial production data, February IP is more a correction following the weak performance in previous months than the start of a strong recovery.

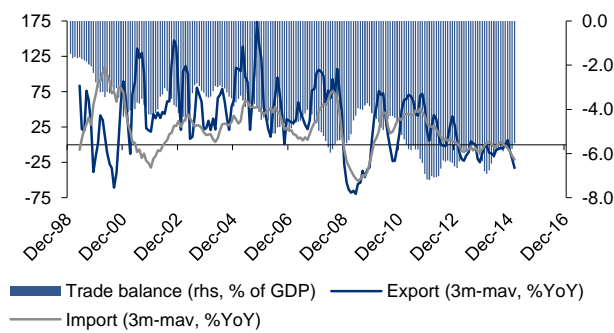
Sluggish domestic demand recovery in 1Q15

- Increased political uncertainty ahead of the general election in June and political criticism of central bank policies, as well as volatility in the global financial markets, led to a sharp weakening in consumer confidence in recent months. Accordingly, the confidence index dropped from 74.0 in Sep to 64.4 in Mar, its lowest level since 2012. The MoM drop in the March figure came from all groups, with the exception of probability of borrowing, buying homes and spending money on home improvements.
- In addition to the drop in consumer confidence, retail lending growth was only 11% as at 3 Apr, implying a weak growth outlook exacerbated by a sluggish domestic demand recovery in 1Q15.

Surprisingly high food prices pushed up March CPI

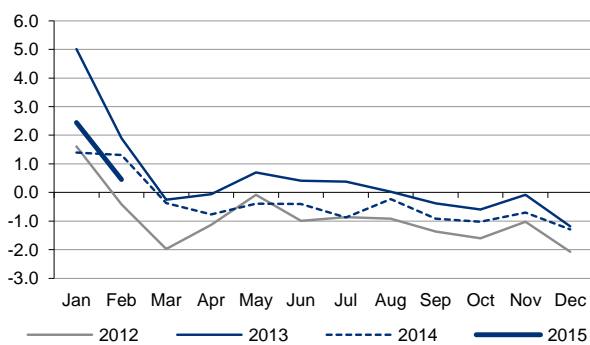
- CPI increased 1.19% last month, well above market consensus at 0.89%, mainly due to the surprisingly high 2.5% hike in food prices. Given substantial base effects from last year, annual inflation rose only slightly to 7.61% from 7.55% in February.
- The breakdown shows that the downtrend in core indicators continued to improve as the H and I indices slowed markedly on an annual basis from 8.44% and 7.73%, respectively, to 7.75% and 7.10%, the lowest levels realised since the start of 2014.
- We see room for improvement in headline CPI over the next few months, aided by base effects, and see acceleration in 2H.

Fig 5 Trade balance (3m)



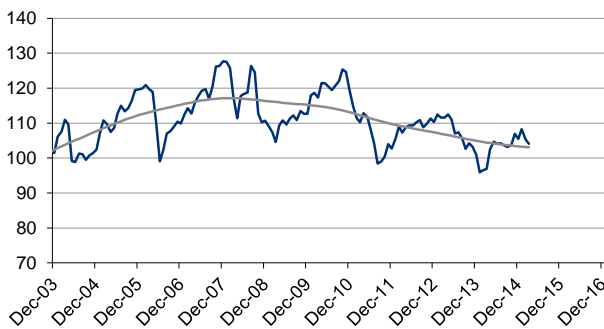
Source: EcoWin, ING estimates

Fig 6 Budget performance YTD (%GDP)



Source: EcoWin, ING estimates

Fig7 FX: REER versus trend (index)



Source: EcoWin, ING estimates

Weak exports in 2015 so far

- The foreign trade deficit was USD4.7bn in February, pulling down the annual deficit to USD81.5bn from USD82.0bn a month ago. Exports were USD12.3bn, down 6.0% YoY, while imports were USD16.9bn, contracting 7.2% YoY.
- Exports were weak on the back of fewer business days, as well as due to the impact of a sharp drop in EUR/USD parity. All chapters declined markedly, with the exception of gold and agriculture products. Excluding gold, annual export growth in February dropped substantially to -13.2%, indicating the impact from this chapter, for which Switzerland appears to be the main market.

Fiscal discipline to be key in attaining ambitious targets

- Public finances performed strongly in 2014 due to one-off revenues from privatisation receipts. Improvement in the primary surplus was also eye-catching due to revenue generation and the measured rise in expenditure versus original yearly targets.
- Following a higher-than-anticipated weakening in Jan-15, non-interest expenditure accelerated again, weighing on the budget outcome, despite improving tax revenues. We also see further support from a restructuring law targeting the payment of tax penalties and overdue social security payments. Fiscal discipline ahead of the general election will be key to attaining the ambitious budget deficit-to-GDP target of 1.1% for 2015.

Pressure on CBT FX reserves

- CBT FX reserves have been declining since Jan given FX volatility stemming from political pressure on CBT, as well as uncertainty in the global financial markets. Accordingly, gross reserves fell to USD121.6bn as of 3 Apr from USD130.9bn on 6 Feb. The net FX position dropped to USD35.1bn, down USD4.3bn, due to the adverse effects of TRY weakness on the dollar value of TRY RRRs held in FX under the ROM framework, FX sale auctions, directly meeting the FX needs of energy importers and ROC adjustments.
- Reserve coverage of total debt due in 12M is relatively low compared with peer countries, increasing worries about further FX volatility ahead of elections, as well as Fed tightening.

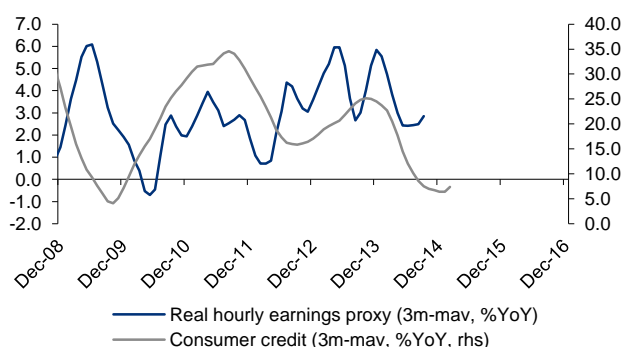
Fig 8 Recent main macroeconomic releases

		Previous-2		Previous-1		Actual	Surprise	Consensus
Capacity utilisation (%)	Jan	73.7	Feb	72.8	Mar	72.4	-	72.5
Industrial confidence	Jan	103.2	Feb	103.4	Mar	103.4	-	103.8
Industrial production (SA WDA, MoM%)	Dec	0.7	Jan	-1.2	Feb	1.7	+	-0.3
Industrial production (WDA, YoY%)	Dec	2.5	Jan	-2.06	Feb	1.0	+	-1.4
Consumer confidence	Jan	67.7	Feb	68.1	Mar	64.4	-	68.5
Unemployment rate (%)	Oct	10.4	Nov	10.7	Dec	10.9	-	11.1
GDP (SA WDA, QoQ%)	Q2	-0.5	Q3	0.6	Q4	0.7	+	0.3
GDP (YoY%)	Q2	2.3	Q3	1.939	Q4	2.58	+	2.1
GDP (WDA, YoY%)	Q2	2.6	Q3	2.0	Q4	2.4	+	1.7
Core CPI (YoY%)	Jan	8.6	Feb	7.7	Mar	7.1	-	7.2
CPI (YoY%)	Jan	7.2	Feb	7.6	Mar	7.6	+	7.2
PPI (YoY%)	Jan	3.3	Feb	3.1	Mar	3.4	-	-
1W repo rate announcement (%)	Jan	7.75	Feb	7.50	Mar	7.50	-	7.50
Overnight borrowing rate announcement (%)	Jan	7.50	Feb	7.25	Mar	7.25	-	7.25
Overnight lending rate announcement (%)	Jan	11.25	Feb	10.75	Mar	10.75	-	10.75
Trade balance (USDbn)	Dec	-8.5	Jan	-4.3	Feb	-4.7	-	-4.3
Current account (USDbn)	Dec	-6.8	Jan	-2.0	Feb	-3.2	-	-2.8

Source: Bloomberg

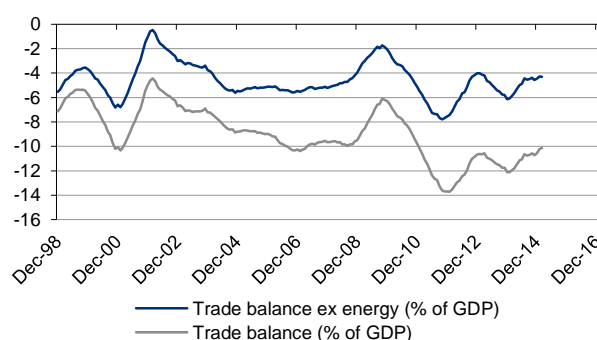
Additional charts

Fig 9 Wages and credit growth



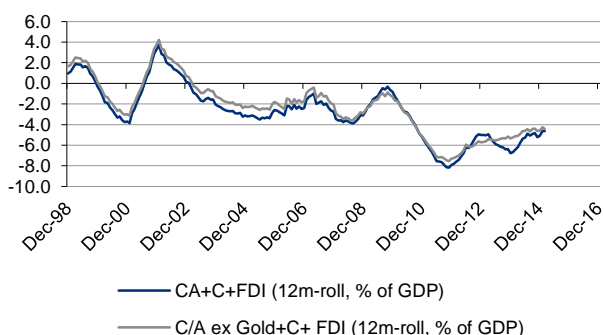
Source: EcoWin, ING estimates

Fig 10 Trade balance (annual)



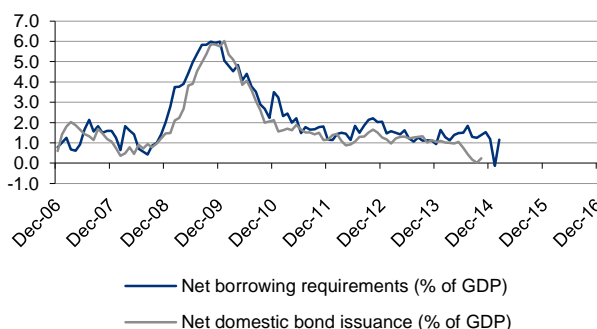
Source: EcoWin, ING estimates

Fig 11 Current and capital accounts + net FDI



Source: EcoWin, ING estimates

Fig 12 Govt central borrowing requirements (annual)



Source: EcoWin, ING estimates

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