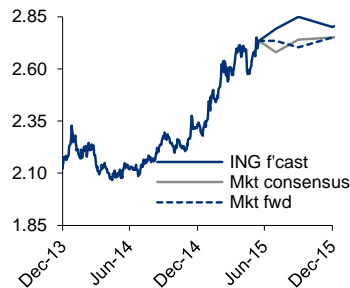


**Economics**  
16 June 2015

### USD/TRY



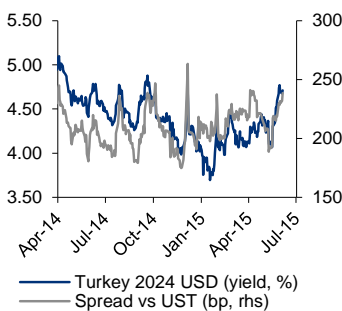
Source: EcoWin, ING estimates

### 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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# MonitorING Turkey

## Still politics...

Following the Mar-14 local elections that produced a clear win for the Justice and Development Party (AKP) and the Aug-14 presidential elections with the election of Erdoğan, a year-long election cycle has recently come to an end with the formation of a new Parliament, while the governing party (AKP) has lost its majority. Even if a combination of the four parties in the Parliament produces a coalition government, this is likely to be fragile due to ongoing polarisation among political parties.

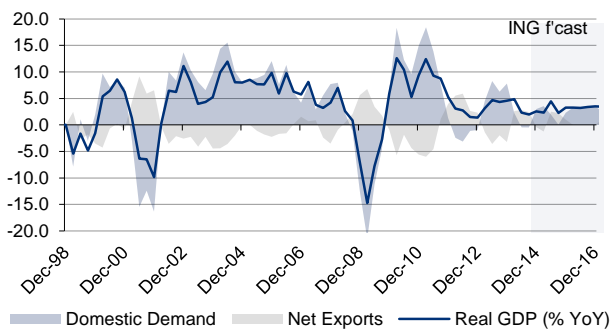
- Given that an ongoing coalition-forming process with a good chance of early elections means a continuation of political uncertainty in the near term, the growth outlook may turn bleak again in 2H15 with increasing downside risks. Accordingly, we revise our 2015 and 2016 growth forecasts from 3.3% and 3.7% to 3.1% and 3.4%, respectively.
- Given the significant deceleration in portfolio inflows in 2015 so far, the election outcome might increase outflows further, requiring additional action from the CBT to backstop TRY. If this were to be the case, the CBT, which has been more inclined to adjust liquidity conditions and macro prudential tools to support the TRY and financial stability in recent months, might opt for a hike in the upper band with further tightening liquidity conditions. More decisive moves, such as a policy rate hike, may be required if TRY weakness persists. Given this environment, we also increase our USDTRY forecasts to 2.80 and 3.00 for end-2015 and end-2016, respectively.
- Regarding inflation, on the food side, the recently established Food Committee might introduce some measures to contain the pressure, which has already softened in May. However, adverse base effects from August, renewed FX pass-through due to recent TRY weakness with the possibility of further depreciation, threaten the inflation path for the rest of 2015, which we expect to close the year at 7.7%.
- FX:** The TRY has suffered YTD, with a further bout of risk aversion and anxiety ahead of the general elections. Now 10% undervalued in real terms, the TRY could still weaken by another 5% in 3Q15 on the same drivers, with the CBT standing ready to smooth the ride.
- Local debt:** Protracted coalition talks could prompt the sale of further bonds by foreigners. To mitigate any outflows, the CBT may widen the corridor on the upper-end. A repo rate hike is an option if the TRY comes under too much pressure. The TKGBs curve is likely to remain inverted in 3Q15.

### Quarterly forecasts

	1Q15	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F
Real GDP (%YoY)	2.3	4.4	2.3	3.3	3.3	3.2	3.4	3.5
CPI (%YoY) eop	7.6	7.5	7.4	7.7	6.6	6.3	6.9	6.8
Policy interest rate (%) eop	7.50	7.50	8.00	8.00	8.50	8.50	9.00	9.00
3-month interest rate (%) eop	10.50	10.70	11.45	11.43	10.63	10.51	10.71	10.84
10-year yield (%) eop	8.44	9.72	10.27	9.12	9.37	9.46	9.75	9.95
Exchange rate (USD/TRY) eop	2.60	2.75	2.85	2.80	2.88	2.93	2.97	3.00
Exchange rate (EUR/TRY) eop	2.79	3.03	2.99	2.80	2.74	2.63	2.76	2.85

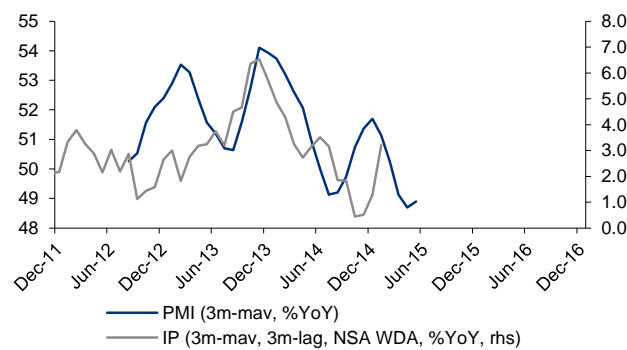
Source: EcoWin, ING estimates

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



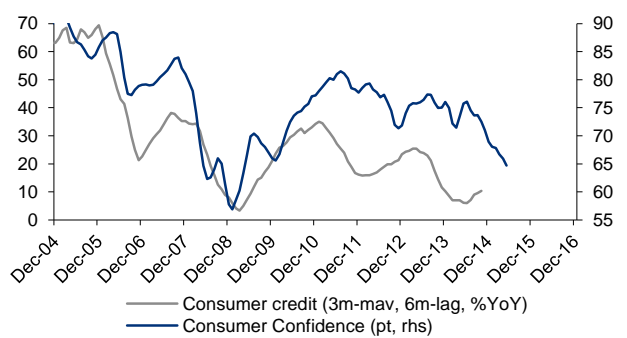
Source: EcoWin, ING estimates

**Fig 2 IP vs PMI**



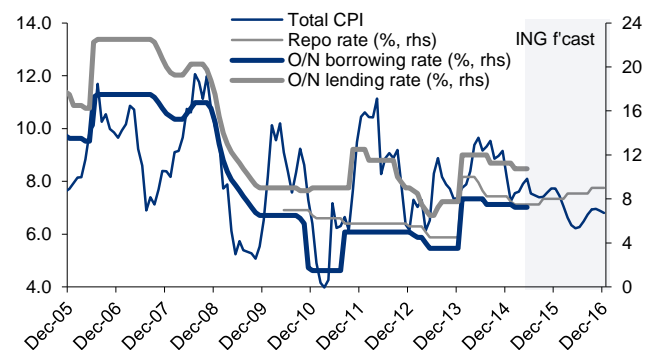
Source: EcoWin, ING estimates

**Fig 3 Consumer confidence vs credit**



Source: EcoWin, ING estimates

**Fig 4 CPI vs policy rate**



Source: EcoWin, ING estimates

**Upside surprise in 1Q15 growth**

- Continuing to gradually improve since 3Q14, economic activity was better than expected in 1Q15 with 2.3% YoY growth.
- Private consumption, as the major driver, continued to improve due to the rate cuts in the first two months. Private investment remained weak with a slightly positive contribution. Public demand was a drag again because of slow growth in consumption and the negative contribution from the investment.
- Net exports reduced the headline attributable to the impact of weak exports on the back of geopolitical developments in the neighbouring countries and impact of lower energy price on the demand of exporter countries.

**A gradual improvement in IP since Jan-15**

- After a weak reading in January, the industrial production index was better than expected in the following months, seeing a 3.8% YoY growth in April vs consensus at 3.1% YoY. However, the seasonally adjusted (SA) IP index that generally follows a volatile path remained flat on a monthly basis and stood close to an all-time high, hinting a setback after two consecutive strong readings.
- Motor vehicles was again the major contributor to the IP, as was the case in the previous four months, followed by pharmaceutical products and other transport equipment dominated by defence industry products. On the flip-side, textile and non-metallic products reduced the headline most with -0.47ppt and -0.27ppt, respectively.

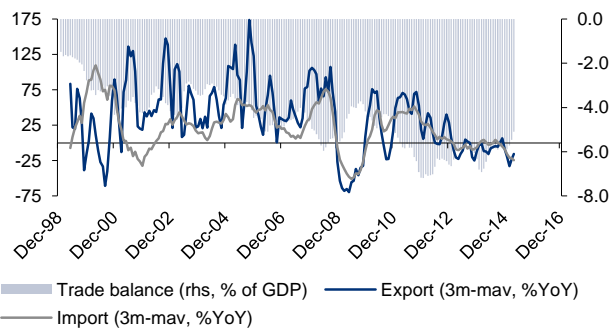
**Improving demand indicators**

- Domestic demand became the main driver of GDP growth in 1Q15 along with a slight support from stock changes and private sector investment, while net exports weighed on the growth performance.
- Early indicators on the supply side with recovering PMI in May to the above-50 threshold for the first time since end-2014, relatively better CUR and business confidence, albeit close to lows sees in recent years, imply that activity further improves in 2Q15.
- Demand indicators also support this view with acceleration in white goods and car sales and relatively better housing demand indicated by signals of a revival in mortgage loans and increasing house sales.

**Inflationary pressure continues**

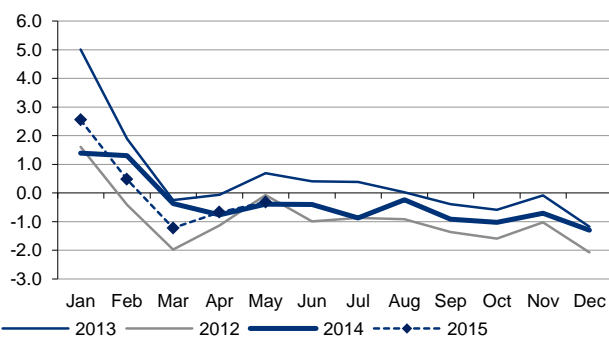
- CPI increased 0.56% last month, better than market consensus at 0.65%, mainly contributed by softening food prices, despite pressure in clothing group and transportation prices. Accordingly, annual inflation moved from 7.91% to 8.09% in April and continued the uptrend that began in Jan-15.
- Trend in core indicators that followed a downward course since November, ended with annual inflation increasing to 7.91% and 7.48%, respectively. The data indicate the impact of FX pass through, as the major driver of deteriorating core trend.
- Overall, inflationary pressures remain strong as seen by rising yearly non-food inflation from 4.8% to 5.9% in the last two months..

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



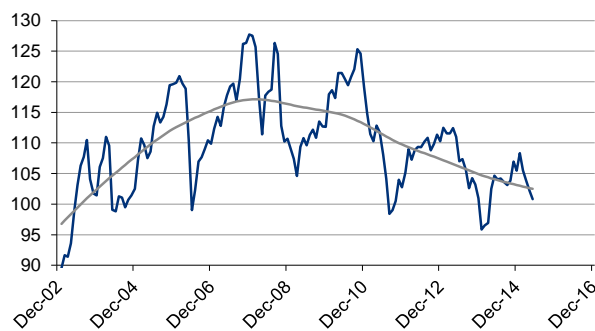
Source: EcoWin, ING estimates

**Fig 6 Budget performance YTD (% of GDP)**



Source: EcoWin, ING estimates

**Fig 7 FX: REER vs trend (index)**



Source: EcoWin, ING estimates

**Gold exports support trade balance**

- Trade deficit came at USD5.0bn in April, pulling the annual deficit down to USD80.1bn from USD82.5bn. Exports that contracted in 1Q15 were slightly positive, while imports continued to register negative growth seen since Feb-14. With energy prices remaining significantly below last year's figures and the recovery in domestic demand still modest, imports maintained a downward trend.
- Gold trade has supported exports in 2015 to date but the overall performance was weak on the back of a sharp drop in EUR/USD parity as currency breakdown reveals that exports in euro and USD each have a 45% share in 2014, while the same ratios are 30% and 65%, respectively, on the imports side.

**Budget balance at surplus in May**

- The May budget saw a contraction in interest expenditures, a continuation of healthy revenue generation driven by tax income and a jump in primary spending. Consequently, the budget balance slightly improved, despite contraction in primary surplus.
- Improvement in tax revenues has determined budget performance so far, despite non-interest expenditures remaining high and weighing on the budget along with a double-digit growth in interest payments. Although we see volatility in monthly realisations, overall fiscal performance has remained on track so far despite general elections. Given early experiences, fiscal discipline should be a concern with a coalition government in power.

**TRY to remain weak**

- Given the new political landscape, markets should remain under pressure due to continued uncertainty, with bond yields possibly returning to double-digit levels and TRY hitting new lows against USD and 50:50 USD:EUR. While TRY remains undervalued as of May-15, we estimate by c.10% in real terms vs the long-term average, the Real Effective Exchange Rate index (REER) still points to room for a further TRY decline of 5% in real terms, taking the long-term low as the benchmark.
- CBT has responded by reducing FX deposit interest rates from 4.0% to 3.5% for USD and from 2.0% to 1.5% for EUR, signalling that it would support banks if FX liquidity needs increase.

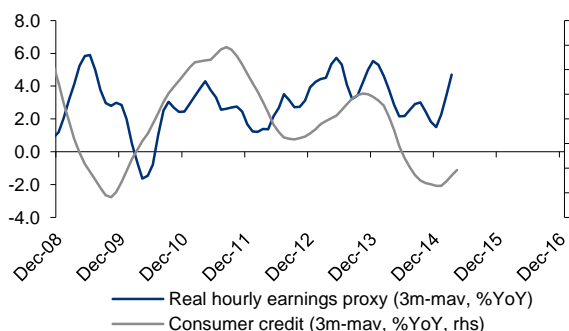
**Fig 8 Main macroeconomic recent releases**

Indicator	Previous -2		Previous -1		Actual		Surprise	Consensus
Capacity Utilization (%)	Mar	72.4	Apr	74.1	May	74.9	-	-
Industrial Confidence	Mar	103.5	Apr	107.9	May	109.0	-	-
Industrial Production (SA WDA, MoM%)	Feb	1.8	Mar	2.3	Apr	0.0	-	0.4
Industrial Production (WDA, YoY%)	Feb	0.9	Mar	4.75	Apr	3.8	+	3.4
Consumer Confidence	Mar	64.4	Apr	65.4	May	64.3	-	66.1
Unemployment Rate (%)	Jan	11.3	Feb	11.2	Mar	10.6	-	10.9
GDP (SA WDA, QoQ%)	Q3	0.4	Q4	0.8	Q1	1.3	+	0.7
GDP (YoY%)	Q3	1.9	Q4	2.6	Q1	2.3	+	1.7
GDP (WDA, YoY%)	Q3	1.9	Q4	2.5	Q1	2.4	+	1.7
Core CPI (YoY%)	Mar	7.1	Apr	7.0	May	7.5	+	7.3
CPI (YoY%)	Mar	7.6	Apr	7.9	May	8.1	-	8.2
PPI (YoY%)	Oct	6.8	Nov	5.7	Dec	7.0	-	-
1W Repo Rate Announcement (%)	Mar	7.50	Apr	7.50	May	7.50	-	7.50
Overnight Borrowing Rate Announcement (%)	Mar	7.25	Apr	7.25	May	7.25	-	7.25
Overnight Lending Rate Announcement (%)	Mar	10.75	Apr	10.75	May	10.75	-	10.75
Trade Balance (\$bn)	Feb	-4.7	Mar	-6.2	Apr	-5.0	-	-4.8
Current Account (\$bn)	Feb	-3.6	Mar	-5.0	Apr	-3.4	-	-2.9

Source: Bloomberg

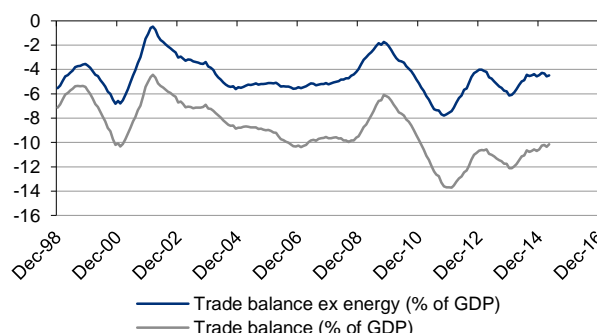
### Additional charts

**Fig 9 Wages and credit growth**



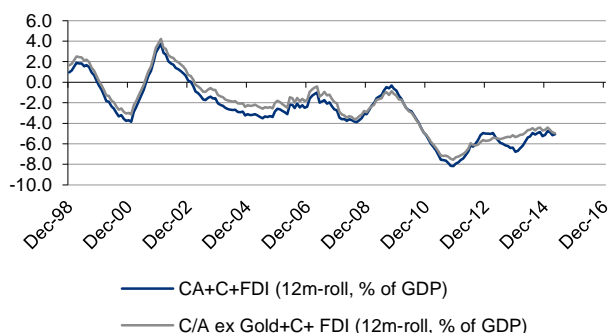
Source: EcoWin, ING estimates

**Fig 10 Trade balance (annual)**



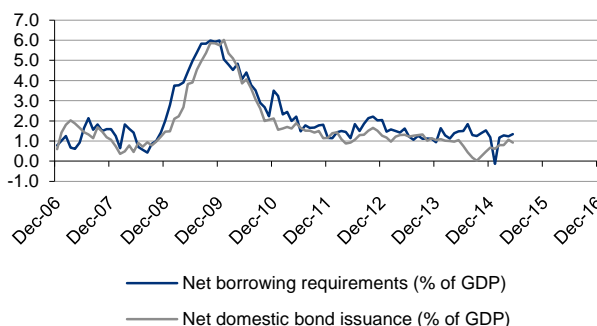
Source: EcoWin, ING estimates

**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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