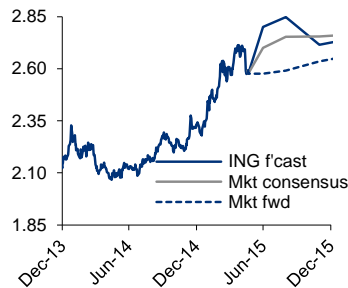


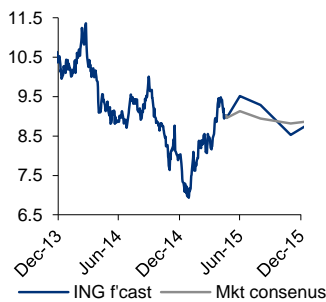
Economics
21 May 2015

USD/TRY



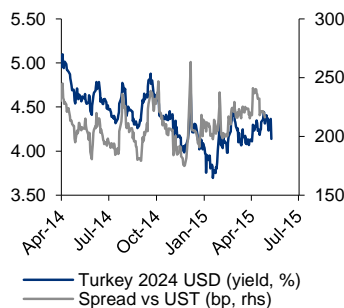
Source: EcoWin, ING estimates

Local 10Y yields (%)



Source: EcoWin, ING estimates

US\$ Eurobond 2024



Source: Bloomberg

Latest indicator surprises

Output	Positive
Consumption	Neutral
Inflation	Higher
External	Neutral
Budget	Neutral

Source: Bloomberg

Muhammet Mercan

Chief Economist, Turkey
Istanbul +90 212 329 0751
muhammet.mercan@ingbank.com.tr

MonitorING Turkey

Uncertainty to remain...

As the general election approaches, recent poll results are not conclusive. Political noise and uncertainty may remain in the near term even after the election given the process of new government formation, appointment of a new economy management team and prospects of constitutional change. Despite strength in recent days supported by the USD decline, Turkish asset markets stand to face some stiff headwinds in the coming months, as well as being impacted by a summer backdrop of better US activity data and higher US rates.

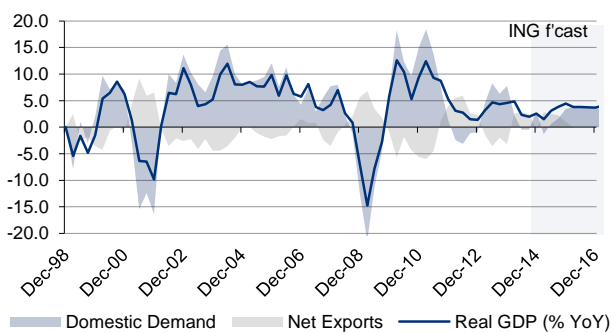
- The CBT revised its 2015 inflation forecast from 5.5% in the first inflation report released in Jan-15 to 6.8% (consensus: 7.3%) in Apr-15. Food prices have significantly pressurized headline CPI in 2015 so far but it is possible there could be a mean reversion going forward, while the recently established Food Committee might introduce some measures to contain the pressure. However, adverse base effects from August and renewed FX pass through with recent TRY weakness threaten the inflation path in 4Q15. Accordingly, we revise our 2015 inflation forecast from 6.7% to 7.4%, also by considering the higher-than-envisaged April reading.
- Recent evidence has hinted that the CBT tends to ease too much in times of low market pressure, which leads to a delayed but sharp tightening when pressures escalate. Therefore, we continue to expect that the CBT will keep the policy rate unchanged throughout 2015, but that a hike in the upper band is possible when the Fed raising interest rates. We see a growing risk that the CBT may act in 2016 with a 100bp hike to anchor inflation expectations that have markedly deteriorated in recent months.
- **FX:** Since the beginning of May, TRY has strengthened against both the USD and a 50:50 USD:EUR basket, reversing underperformance relative to EM peers. Given that political uncertainties are likely to weigh on the performance of Turkey in the near term as we approach the June general election, we continue to be bearish for TRY.
- **Local debt:** Higher than envisaged inflation data in 2015 so far, sluggish global risk appetite and local politics have pushed bond yields significantly up, although there has been some recovery in recent days with more bullish sentiment from foreign investors. We think that there could be scope for some further recovery, but don't expect it to last long.

Quarterly forecasts

	4Q14	1Q15	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F	3Q16F
Real GDP (%YoY)	2.6	1.5	3.1	3.9	4.4	3.8	3.8	3.7
CPI (%YoY) eop	8.2	7.6	7.0	7.2	7.4	6.3	6.2	6.6
Policy interest rate (%) eop	8.25	7.50	7.50	7.50	7.50	8.00	8.00	8.50
3-month interest rate (%) eop	10.02	10.50	10.70	10.71	10.00	10.26	10.14	10.12
10-year yield (%) eop	8.02	8.44	9.51	8.96	8.56	9.38	9.42	9.54
Exchange rate (USD/TRY) eop	2.33	2.60	2.80	2.80	2.70	2.76	2.78	2.81
Exchange rate (EUR/TRY) eop	2.82	2.79	3.02	2.80	2.57	2.54	2.50	2.61

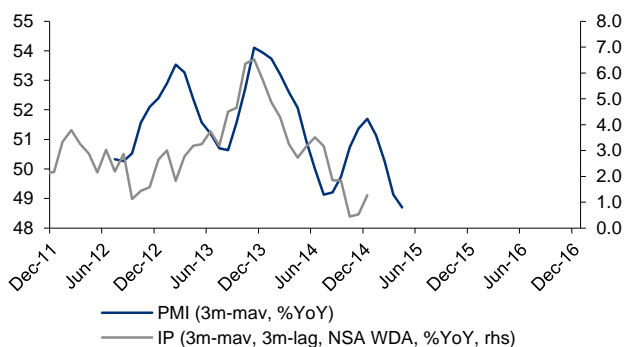
Source: EcoWin, ING estimates

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



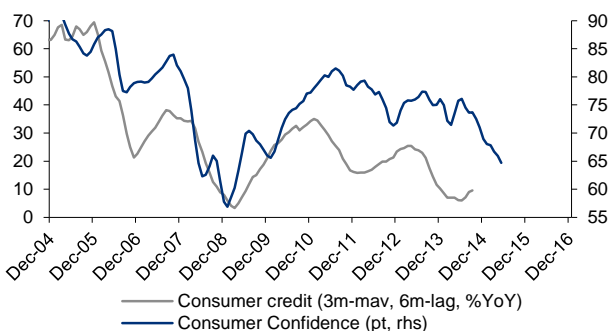
Source: EcoWin, ING estimates

Fig 2 IP vs PMI



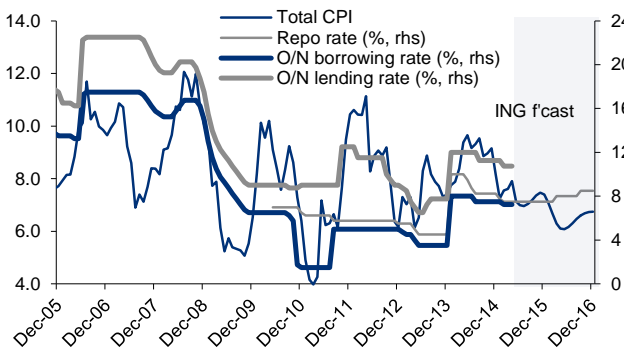
Source: EcoWin, ING estimates

Fig 3 Consumer confidence vs credit



Source: EcoWin, ING estimates

Fig 4 CPI vs policy rate



Source: EcoWin, ING estimates

Loss of pace in economic activity in 1Q15

- Production of consumption goods has improved in the past two months, though off a low base in 1Q15. Given a relatively flat capacity utilization rate and weak business confidence, appetite for investment expenditure seems at a slow pace.
- The latest supply side indicators, including business tendency, capacity utilization and PMI still signal continuation of a relatively weak outlook on the production side.
- Impacted by the fall in consumer confidence, at close to its lowest level in more than three years, consumption demand remains sluggish, though it appears to have improved recently as signalled by some acceleration in vehicle and white goods sales.

Unexpected strength in March IP

- Starting the year with a weak reading in January, the industrial production index turned out to be better than expected for the remainder of 1Q15, with a strong 4.7% YoY in March vs consensus at a mere 0.9% YoY. However, the QoQ change in the 3-month average IP (SA) was a relatively low 1.2%, albeit an improvement in comparison to the performance in 4Q14, hinting at weak momentum on the production side.
- Overall, IP data in 1Q15 shows a loss of pace in activity, driven by both domestic and external factors. The latest indicators in April, including business tendency, capacity utilization and PMI signals a continuation of relatively weak outlook on the production side.

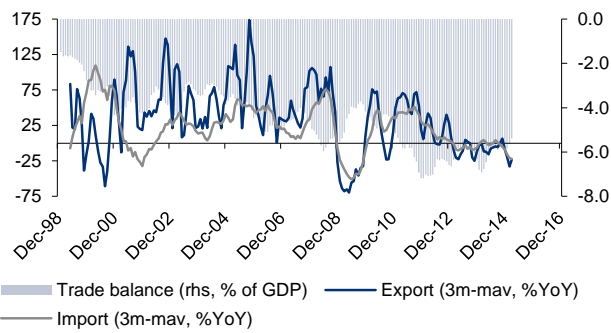
Credit expansion under control

- Growth of commercial loans has remained close to the long-term average while growth of consumer loans has receded to below the average rate of increase in recent years, which, in turn, supports macro financial stability and the rebalancing process.
- Diverging growth rates of commercial and consumer loans are attributable to the macro prudential measures taken by the BRSA.
- According to the CBT, despite a possible acceleration in lending expansion in the near term due to the base effects, underlying trend in loans is expected to remain under control and growth should be close to the reference rate at 15%, which is also our base case.

Upside surprise in April CPI

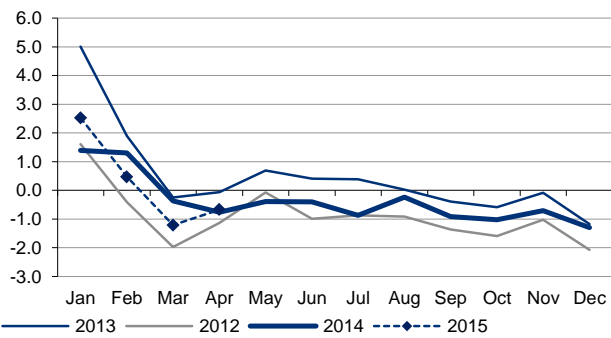
- CPI increased by 1.63% last month, well above consensus at 1.4%, driven mainly by clothing and food prices. One of the highest April readings in more than ten years pulled annual inflation up from 7.61% in March to 7.91% and continued the uptrend started in Jan-15.
- H&I core indicators rose 1.78% and 2.03%, respectively, but pulled annual inflation down to 7.60% and 7.00% (both the lowest realised since the last quarter of 2013) due to base effects.
- We might see a mean reversion in food prices from current high levels in the coming period, given the improvement in weather conditions with consequent recovery in agriculture production.

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



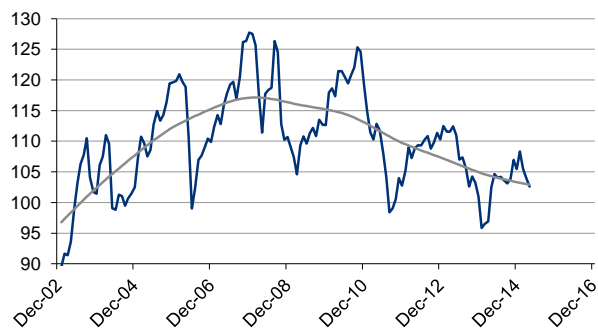
Source: EcoWin, ING estimates

Fig 6 Budget performance YTD (% of GDP)



Source: EcoWin, ING estimates

Fig 7 FX: REER vs trend (index)



Source: EcoWin, ING estimates

Exports continued to drop in March

- Foreign trade deficit was US\$6.2bn in March, pulling the annual deficit up from US\$81.5bn a month ago to US\$82.4bn. Exports stood at US\$12.6bn, down in three consecutive months on a YoY basis by 14.4% in March alone, while imports amounted to US\$18.7bn, and contracted by 6.1% YoY, continuing to register negative growth rates since Feb-14.
- Sluggish imports are being driven by lower commodity prices. Exports, however, turned out to be weak on the back of a sharp drop in EUR/USD parity. Accordingly, the 12M rolling deficit recorded a slight increase, ending the general improvement trend since the beginning of 2014.

Strong performance in April budget

- Budget balance turned into a surplus in April from a deficit in the same month of 2014 due to hefty revenue generation and relatively lower primary spending, despite surging interest expenditures. Accordingly, we see improvement in the primary balance on annual basis with a TRY7.5bn surplus, down from a mere TRY1.1bn reading in Apr-14.
- Improving performance in tax revenues has determined the budget performance in 2015 so far, despite non-interest expenditures remaining close to double-digit levels weighing on the budget outcome along with jump in interest payments, hinting continuing adherence to fiscal discipline ahead of the general election.

CBT to maintain liquidity squeeze

- In recent days, EM currencies have performed well with TRY in the frontline. But we think another bout of pressure on the TRY is possible given another resurgence of the US dollar still seems likely. While TRY remains undervalued by around 8% in real terms as of Apr-15, the REER index still points to room for a further TRY decline of 6-7%, if we take the long-term low seen in Jan-14 as the benchmark.
- The CBT generally tends to ease too much in times of low market pressure, which leads to a delayed but sharp tightening when pressures escalate. However, we think the CBT will maintain tight liquidity ahead of the general election, despite current TRY strength.

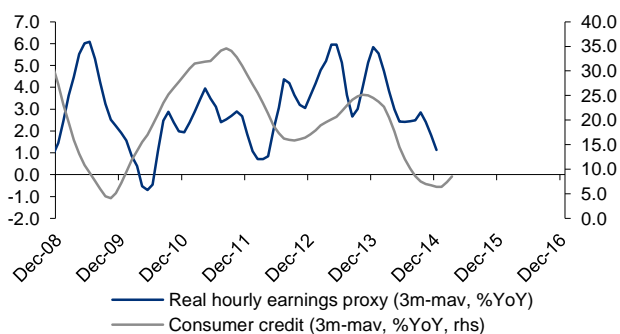
Fig 8 Main macroeconomic recent releases

Indicator	Previous -2	Previous -1	Actual	Surprise	Consensus
Capacity Utilization (%)	Feb 72.8	Mar 72.4	Apr 74.1	+	73.6
Industrial Confidence	Feb 103.4	Mar 103.5	Apr 107.9	-	-
Industrial Production (SA WDA, MoM%)	Jan -1.2	Feb 1.8	Mar 2.2	+	1.4
Industrial Production (WDA, YoY%)	Jan -2.1	Feb 0.9	Mar 4.7	+	0.9
Consumer Confidence	Mar 64.4	Apr 65.4	May 64.3	-	66.1
Unemployment Rate (%)	Dec 10.9	Jan 11.3	Feb 11.2	-	11.35
GDP (SA WDA, QoQ%)	Q2 -0.5	Q3 0.6	Q4 0.7	+	0.3
GDP (YoY%)	Q2 2.3	Q3 1.9	Q4 2.6	+	2.1
GDP (WDA, YoY%)	Q2 2.6	Q3 2.0	Q4 2.4	+	1.7
Core CPI (YoY%)	Feb 7.7	Mar 7.1	Apr 7.0	+	6.7
CPI (YoY%)	Feb 7.6	Mar 7.6	Apr 7.9	+	7.7
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)	Jan -4.3	Feb -4.7	Mar -6.2	+	-6.2
Current Account (\$bn)	Jan -2.4	Feb -3.5	Mar -5.0	-	-4.3

Source: Bloomberg

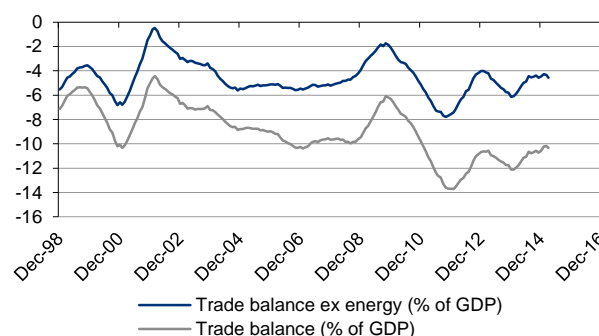
Additional charts

Fig 9 Wages and credit growth



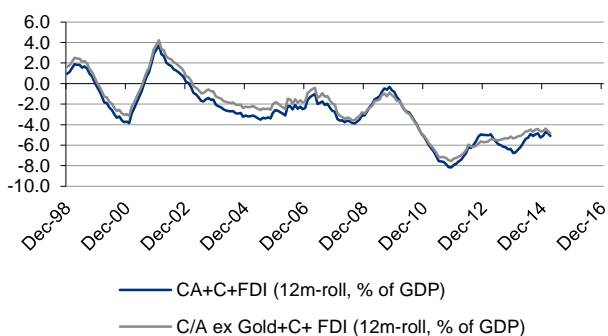
Source: EcoWin, ING estimates

Fig 10 Trade balance (annual)



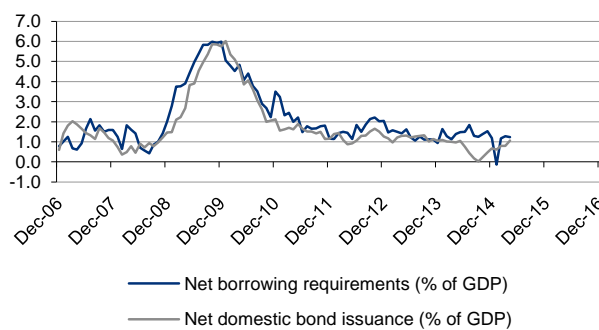
Source: EcoWin, ING estimates

Fig 11 Current and capital accounts + net FDI



Source: EcoWin, ING estimates

Fig 12 Govt central borrowing requirements (annual)



Source: EcoWin, ING estimates

ING Bank A.Ş. Economic Research Group

Muhammet Mercan Chief Economist + 90 212 329 0751 muhammet.mercan@ingbank.com.tr

DISCLAIMER:

Investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided in accordance with a contract of engagement on investment advisory concluded between brokerage houses, portfolio management companies, non-deposit banks and clients. Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely to this information stated here may not bring about outcomes that fit your expectations.

This report has been prepared by ING Bank A.Ş. Economic Research Group solely for the information purposes of its readers. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, ING Bank A.Ş. makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Neither ING Bank A.Ş. nor any of its officers or employees accepts any liability for any direct or consequential loss arising from any use of this report or its contents. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING Bank A.Ş. All rights are reserved.

ING Bank A.Ş. is responsible for the distribution of this report in Turkey.