BBVA | RESEARCH

Turkey Economic Outlook

2ND QUARTER 2016 | TURKEY TEAM

01
The Economic activity continues to be resilient

02
Better inflation data prompts a new stance of monetary policy

03
The current account adjustment continues and deficit is now mostly structural

04
Uncertainty about global markets, politics and geopolitics persist

Index

Closing date: 16 May 2016

1 Editorial

The second quarter of the year has brought some positive news for the Turkish economy. First, **the economic resilience continues** and the economy finally grew at 4% GDP last year, after a surprising 5.7% YoY growth during the last quarter. Still, our high frequency models signal a 4% GDP growth during the first quarter and the support from some tailwinds like the minimum wage hike, the start of the easing cycle of monetary policy and a significant positive term of trade shock will support our GDP forecasts for this year.

The second positive news came from the inflation front. **Thanks to an extraordinary drop in local food prices the risk of reaching two digits inflation disappeared and the latest inflation data have surprised to the downside during three consecutive months**. True, the core inflation is still high but the reduction of the headline has facilitated the start of the monetary policy easing cycle initiated by the former Central Bank Governor Basci and later confirmed by the new Governor Murat Cetinkaya.

The third round of good news arrived from the external sector. **The lower oil prices, but also the adjustment of the credit growth; the current account deficit continued to come close to the 4% area when only three years ago it was hovering around the 10% mark**. Besides, the financing of the deficit is now more favourable and dependent on long term credit flows rather than volatile portfolio flows.

Looking ahead some challenges remain. After the sizeable current account adjustment most of the deficit is now structural. **Energy prices could continue to support the adjustment in the current account deficit but going further will require coping with the structural problems**. Coping with the low private sector savings problem will be a priority if investment start to recover. Otherwise, the external sector will revive old woes.

Although there is a positive central scenario, **the balance of risks is still on the downside due to uncertainty about the sustainability of global markets, the renewal of political uncertainty and the permanent delicate situation of Middle East geopolitics.**

While the global emerging markets and flows have encouraged most of the emerging markets including Turkey the global factor behind is driven by risk appetite spurred by support from the big central banks. As long as this is not matched by fundamentals the sustainability is not guaranteed.

The resignation of Prime Minister Davutoglu has also sparked some uncertainty about the political scenario for the medium term. As the agenda to modify the constitution is alive there are some alternative possibilities. The first scenario will be to name a new Prime Minister and try to obtain the necessary votes to claim a referendum to change the constitution. If this is not possible, a snap election could be called. There is also the possibility of some fragmentation in the political parties which opens up some new possibilities. In any case, the increase in uncertainty has already passed through to the markets, although we expect it to gradually die out.

Last, but not least, the geopolitical situation remains challenging. While the offensive to Aleppo is far from over, the possibility of Turkey fighting ISIS in Syria will be an issue and the situation is rapidly worsening in Iraq. Further, the migration problem will persist and the negotiations with the EU about the migrants deal could increase. The refugees plan has decreased the flow of migrants to the EU notably but disagreements in the conditions on visa liberalisation will require more diplomatic efforts.

2 Global Economic Outlook

Low and fragile global growth conditional on China

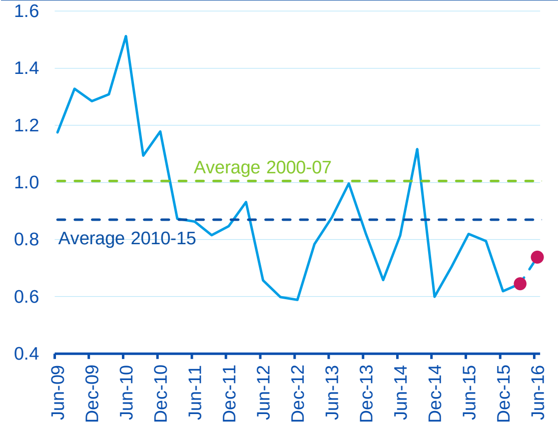
Available data so far confirms our forecast of world GDP growth stabilisation at reduced rates (2.9% annualised rate in Q1 2016) and although slightly higher than that registered by the end of 2015, it is insufficient to meet our original year forecast of 3.2% for 2016 as a whole. This comes in the light of incoming data from production, trade and confidence globally.

China's protracted slowdown and the related weaker activity cycle in the other Emerging Markets (EM) will trim our original yearly estimates unless we witness a substantial improvement in economic growth in the US and Japan.

The strengthening of stimulus policies, both monetary and fiscal, by the Chinese authorities has contributed to easing the effects of the readjustment in the manufacturing sector on aggregate production and, consequently on the country's trade flows with the rest of the world. In the short term, the implementation of counter-cyclical measures may facilitate a more gradual slow-down of the economy than expected.

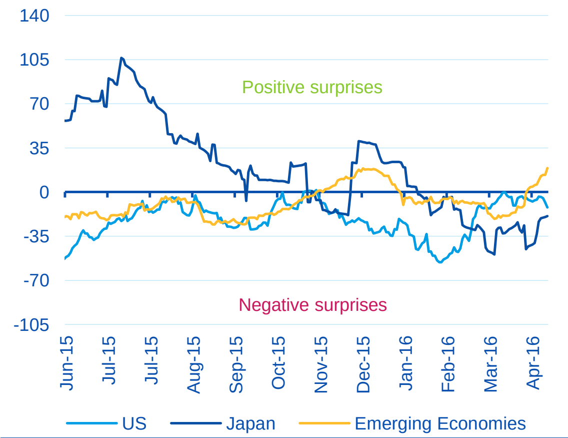
However more efforts are needed ahead, as a delay in the correction of the country's fundamental imbalances (such as corporate leverage and spare capacity in legacy industries and construction) increase the financial vulnerability of China, and financial shocks like those from summer 2015 would be amplified and prone to reach systemic dimension for the rest of the world.

Figure 2.1
World GDP, % q/q. Q1 and Q2 forecasts 2016 based on BBVA-GAIN



Source: BBVA Research

Figure 2.2
Economic Surprise Indexes (CESI)



Source: BBVA Research and Haver

But tail risks recede…

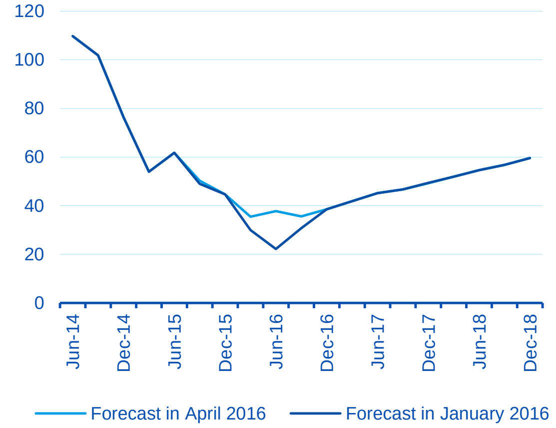
The former weak outlook should not hide the fact that tail risks have fortunately reduced in both severity and probability. The sharp increase in financial volatility observed in the transition from 2015 to 2016 (see figure 1.3) has subsided to a certain extent thanks to (i) decisive policy action in many developed markets in preventing negative feedbacks between financial tensions and decelerating global activity (via self-fulfilling expectations feeding into demand decisions), (ii) a better than expected balance of economic indicators from China (iii) lower depreciation pressures on the RMB, (iv) an apparent modest recovery in the commodity prices cycle and (v) a moderation in the expected Fed interest rate normalisation path.

However, as can be seen in graph 2.4 most of the improvement in the global component sustaining capital flows is relying on risk appetite variable rather than on fundamental data. Thus, the lack of economic recovery or a failure by Central Banks in sustaining the risk appetite can easily turn into a less favourable environment.

Perspectives for oil prices

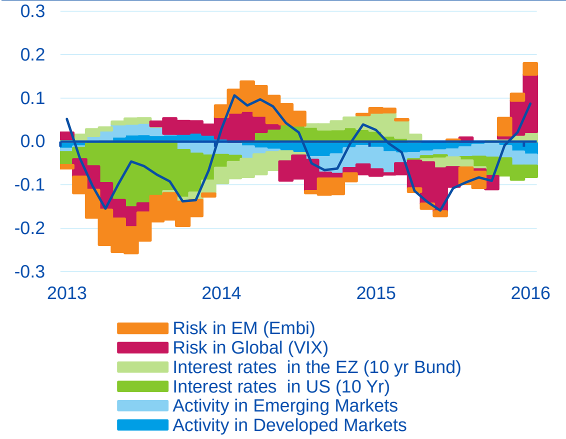
The stabilisation of activity in China partly explains the recovery of prices of the major raw materials from the minimum levels reached in January. In the particular case of oil (the WTI barrel price increased by 10 dollars to achieve levels of 43), the increase was due, to a large degree, to greater supply restriction than forecast (reduction in US production, supply cuts in countries such as Iraq and Nigeria, and expectation of an agreement between the OPEC countries to freeze their production) and to the depreciation of the dollar (see figure 2.3). These prices are still favourable for the Turkish economy and entail lower risk from the geopolitical side than the previous forecast.

Figure 2.3
Oil price forecast (dollars per barrel)



Source: BBVA Research

Figure 2.4
Decomposition of the Global Factor of Capital Flows (Push and Pull factors)



Source: BBVA Research

Bias to growth forecasts remains to the downside

All in all the world economic outlook remains fragile and dependent on how the Chinese economy evolves, delicate DM-EM policy stand-offs, the resolution of hot spots of instability around Europe (geopolitics, "Brexit", payment of the Greek debt) and a possible slow-down in the US. Although extreme risks have somehow receded a re-emergence of a new episode of financial volatility cannot be ruled out in a context of heightened uncertainty over the ability of the EMs to prevent a downturn and of the DM Central Banks to keep up sustainable growth. As mentioned before, the ability of the big central banks to sustain the capital flows to EM and avoid volatility will also be a challenge.

3 Turkish Economic Outlook

Activity moderates towards its potential…

Turkish economy expanded by 5.7% in the last quarter of 2015, pulling up the whole year growth rate to 4%. Strong private consumption on top of a loose fiscal policy facilitated a close-to-potential growth rate in an environment with heightened global market volatility, a challenging geopolitical environment and an uncertain political situation.

To 4% growth rate in 2015, domestic demand contributed 4.3pp, while external demand had a slight negative contribution (0.3pp). Private consumption took the lead with solid growth of 4.5% (3.0pp contribution) while private investment grew by 2.7% (0.5pp contribution), still weak but the highest rate since the extremely high growth rates of 2011.

The BBVA-Garanti Research monthly GDP indicator signals a slowdown in economic activity to 4% in 1Q16 from the unsustainable level of 4Q15. Although manufacturing activity remained robust, lower external demand mainly due to Russian sanctions and lower tourism revenues were behind the moderation in 1Q16.

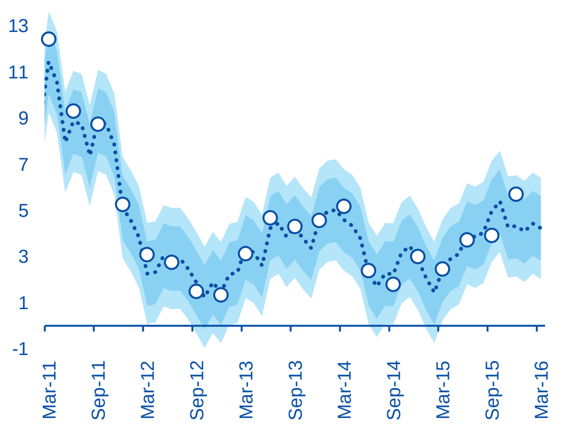
Table 3.1
Turkey: Activity Indicators* (3MA, YoY, indices are SA)

					2016			
	Mean	Oct	Nov	Dec	Jan	Feb	Mar	Apr
Industrial Production	5.9	4.6	3.1	7.5	4.0	5.5	5.6	
Non-metal Mineral Production	4.2	1.5	-0.2	5.4	2.0	6.5	5.7	
Electricity Production	4.9	4.4	4.2	6.5	5.3	5.7	4.1	
Auto Sales	14.4	7.8	-1.0	3.5	3.9	0.9	-6.0	
Tourist Arrivals	5.4	-3.1	-2.6	-3.9	-4.5	-8.0	-10.3	
Number of Employed	4.4	3.3	3.2	3.0	3.0			
Number of Unemployed	0.6	2.7	1.7	2.0	1.2			
Auto Imports	18.3	12.3	3.7	5.6	5.7	2.8	0.2	
Auto Exports	9.3	29.6	21.5	23.1	5.0	7.3	6.6	
Financial Conditions	74.6	82.2	80.4	80.5	79.1	79.3	84.8	87.8
Credit Growth-13week	21.7	4.0	7.8	10.2	6.2	9.6	9.4	12.1
PMI Manufacturing	51.9	49.5	50.9	52.2	50.9	50.3	49.2	48.9
Real Sector Confidence	107.7	103.6	110.2	108.8	105.9	105.2	104.1	105.7
MICA Forecast							4.0%	
GDP YoY				5.7%				

Contraction	Slow-down	Growth	Boom

Source: BBVA-Garanti Research Monthly GDP Model, Turkstat

Figure 3.2
Turkey: BBVA-Garanti Research Monthly GDP (YoY)



Source: BBVA-Garanti Research Monthly GDP Model, Turkstat

The unemployment rate declined to 9.9% (SA) in 1Q16 from 10.4% in 4Q15, thanks to resilient economic growth. Although the economy's job creation capacity mainly remains in place (close to 850K SA annual), a gradual increase in labour force participation and influx of refugees into unregistered labour market keep the unemployment rate close to double digits.

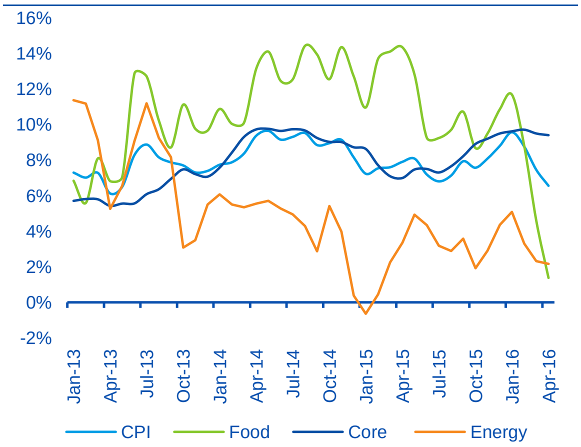
Associated with the robust domestic consumption, the services sector continues to be the single main source of employment growth. On a 12 month rolling basis in 1Q16, the Turkish economy created 847,000 jobs. The services and construction sectors created 683,000 and 140,000 jobs respectively, while the industrial sector reduced employment by 75,000.

Better than expected inflation supported by the non-core factors

Annual headline consumer price inflation fell to 6.6% in April from 8.8% at 2015 year-end. The fall was almost entirely due to extraordinarily low unprocessed food inflation and favourable base effects.

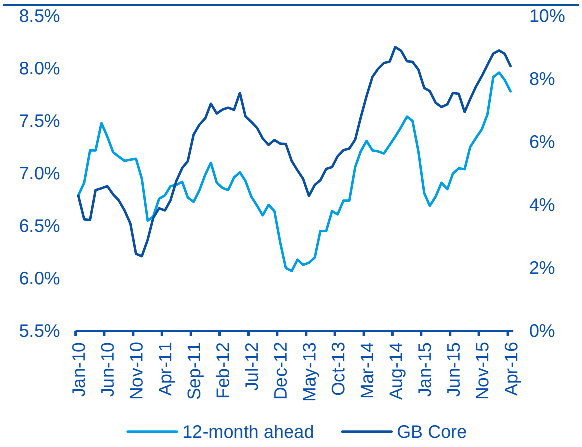
Despite the rapid decline in the headline, the core component remained stubbornly high above 9%. Lagged impacts of exchange rate pass-through and cost push impacts of the minimum wage hike, especially in the labour intense services sector, are the main factors to keep core inflation sticky.

Figure 3.3
Annual inflation



Source: TURKSTAT, BBVA Research and Garanti Bank

Figure 3.4
Annual inflation expectations and GB Core



Source: BBVA-Garanti Research Monthly GDP Model, Turkstat

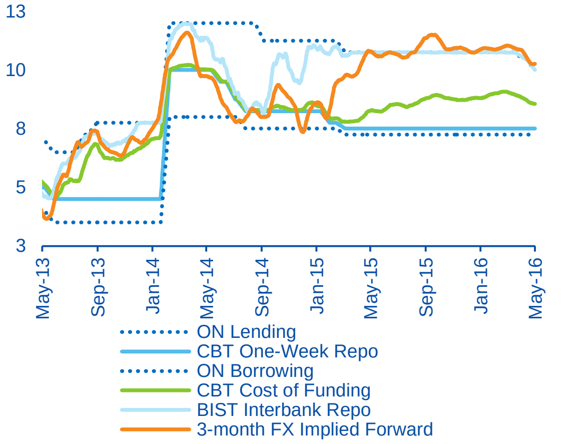
… which supported the start of the easing cycle by the Central Bank

Recent improvement in global risk appetite, as well as sharp decline in headline inflation allowed the monetary policy committee chaired by newly appointed governor Murat Cetinkaya to reduce the marginal funding rate (upper limit of the interest rate corridor) for a second month in a row in April. Marginal funding rate stands at 10.0% as of May, 75bps lower compared to December.

The CBRT's recent easing actions were mainly justified by favourable uncontrollable factors, both external and local. After the Federal Reserve signalled a much flatter path for the rate hikes, portfolio flows to emerging markets intensified while global nominal and real interest rates were suppressed further. On the local front, as the annual headline inflation fell to 7.5% in March, ex-post real interest rate on the CBRT's average funding rate (8.7% April average) rose by over 1%. These allowed the CBRT to start normalising its monetary policy by reducing the marginal funding rate by 75bps.

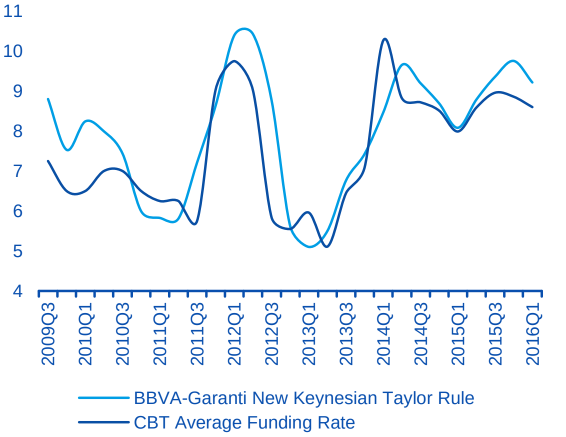
However, due to still very high core inflation, the CBRT's adjustment in average funding rate was much more modest at 20bps to 8.6% in May, from 8.8% at the start of the year. Confirming this, mainly due to high core inflation and close-to-potential output, the New Keynesian Taylor rule from our DSGE-SOE model suggests a policy rate still near 9% to attain the 5% target inflation.

Figure 3.5
CBRT rates corridor vs. Interbank repo rates (%)



Source: CBRT, BIST, BBVA Research and Garanti Bank

Figure 3.6
Official rates and Taylor rules estimation (%)

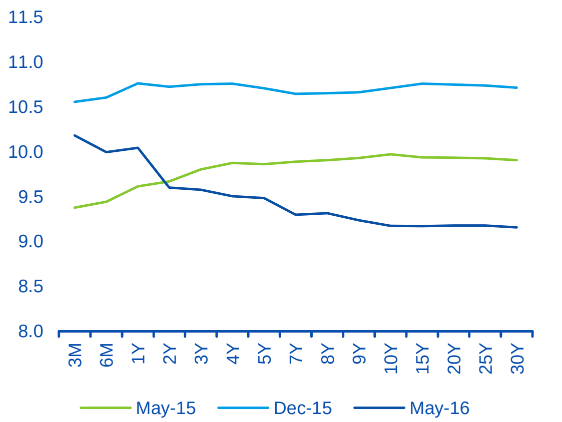


Source: CBRT, BBVA Research and Garanti Bank

Developments on the rates front were more visible, as inflation retreated sharply and the CBRT reduced the marginal funding rate two months in a row. Treasury yields shifted down by some 120 bps on the front end of the curve falling below the 10% mark. The fall on the long-end of the curve was less benign by some 50bps to 10.2%, as long-term inflation expectations remained high due to the deteriorating core inflation trend.

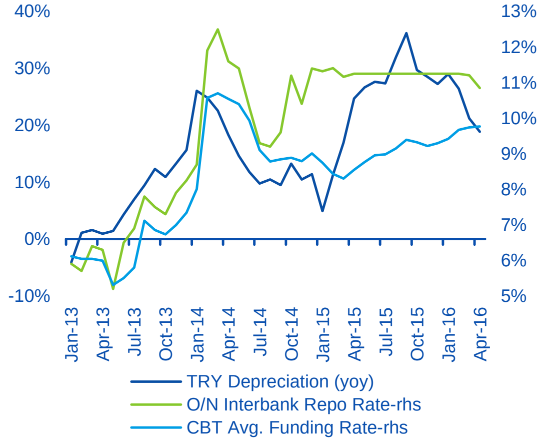
Portfolio flows to Turkey turned to positive for the first time since the beginning of last year. Most of the recovery was driven by global push factors but local pull factors were increasingly supportive (see Global part). After incurring heavy sell-offs, Turkish lira and financial assets recovered somewhat as global risk appetite improved and portfolio flows turned to positive. After depreciating by over 3.1 points against the dollar, the lira pared its losses year to date as of May 11.

Figure 3.7
TRY yield curve (%)



Source: CBRT, BIST, BBVA Research and Garanti Bank

Figure 3.8
TRY YoY depreciation & O/N repo rates



Source: CBRT, BBVA Research and Garanti Bank

Fiscal metrics solid but non-interest expenses deserve a closer watch

Budget performance continued to be solid in 1Q16 supported by both stronger than budgeted revenues and declining interest expenditures due to the lengthening of average debt maturity. Solid public finances and resilient growth remain key to sustain Turkey's investment grade rating. Yet, S&P, which rates Turkey one notch below investment grade, increased the rating outlook from negative to stable citing these two factors as the main driver in May.

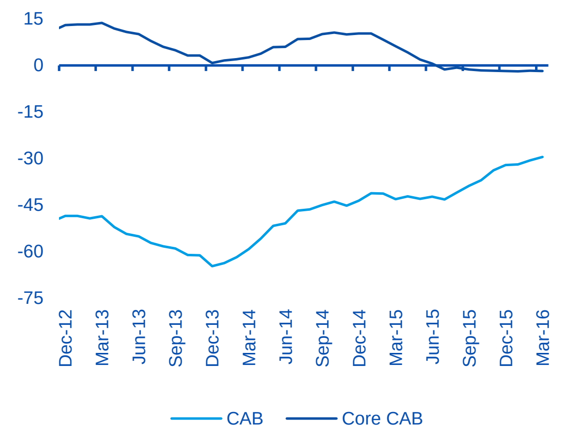
In 1Q16, tax revenues rose by 13% (yoy), while non-tax revenues were exceptionally supportive at 37% (yoy) on one-off privatization revenues. Hence, total revenues climbed by 16% (yoy), better than the Medium Term Plan (MTP) whole year target of 12%. On the other hand, the annual rise in non-interest expenditures reaching 15% is worth monitoring as the pick-up concentrated on mainly current transfers. All in all, the decline in interest expenditures helped the growth rate total expenditures (11%) to be in line with the MTP target (13%). We forecast the budget deficit to GDP ratio at 0.9%, with the primary balance/GDP ratio standing at 1.9% in 1Q16, slightly improved from the levels of -1.2% and 1.6%, respectively, at the end of 2015.

Current Account Deficit (CAD) fell under USD30bn mark…

The Current account deficit further narrowed down to USD 29.5bn (4.2% of GDP) in 1Q16 from USD 32.1bn (4.5% of GDP) at the end of 2015. The adjustment still continues, albeit at a lower rate due to the deterioration in tourism and export revenues. The quarterly decline is almost entirely thanks to lower oil prices, while the services balance worsened as much as 0.2% of GDP mainly due to the significantly declining tourism revenues. **Tourism revenues declined markedly by 16.5% (yoy) in 1Q16 (USD 0.8bn in nominal terms).**

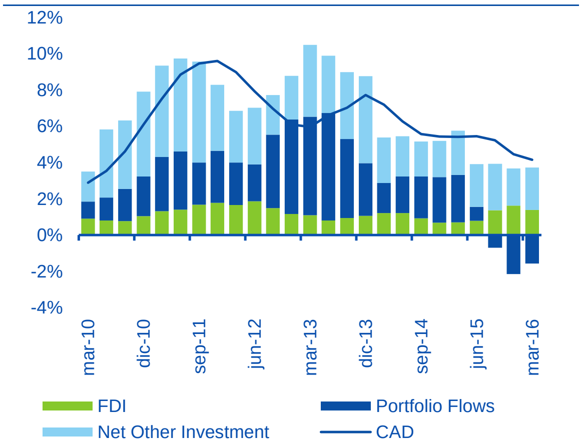
The financing profile has also improved. Portfolio flows turned to positive in February and March, dragging down the 12-month outflows by USD 4.4bn (0.6% of GDP). Net foreign direct investments declined to USD 9.8bn from USD 11.7bn at the end of 2015, albeit with an increasing share of 33% in financing. Private sector loans continued to be the largest component (55%), while CBRT's reserve depletion contributed to the financing by USD 6.1bn (21%) and error and omissions inflows stood at USD 8.2bn (28%).

Figure 3.9
Structural and Cyclical Current Account Deficit (% of GDP)



Source: BBVA Research and Garanti Bank

Figure 3.10
Current Account Balances Factor Decomposition (12 months cumulative,% of GDP)



Source: CBRT, BBVA Research and Garanti Bank

… risks are neutral around our 3.9% GDP growth forecast

In the short term, and after including 80% of the data, our monthly GDP model points at a close to 4% growth rate in 1Q16, slowing down from an unsustainable 5.7% in 4Q15. Some further deceleration may be on the way in 2Q16, as the weak tourism sector gradually weighs and PMI remains weak.

Compared to our previous estimate, we expect a less favourable external demand due to negative impact of terrorist attacks and Russian sanctions on exports and tourism revenues. We forecast a total negative impact of 0.6ppt of GDP stemming from Russian sanctions and terrorist events. The tourism sector will be the biggest loser, however private consumption and investment would be hurt through the confidence channel.

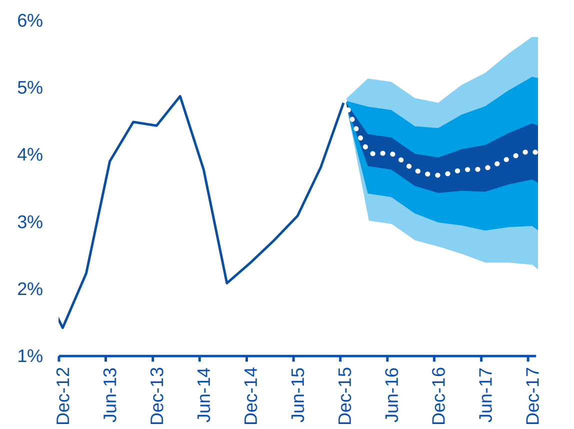
However, **there are several factors that support the maintenance of our previous forecasts of 3.9% GDP growth in 2016. First, we forecast now a more accommodative monetary policy thanks to more than expected decline in inflation. This will be matched by the loose fiscal position stemming from the impact of the minimum wage hike on domestic demand. Last, but not least, the positive impact from the international terms of trade shock will persist**. Given these external tailwinds we believe that the risks to our forecasts are neutral.

… while inflation will be lower thanks to low food prices

So far in 2016**, inflation undershot our initial expectations with a margin, mainly due to extraordinarily low unprocessed food inflation**. Despite the rapid fall in the headline, the core component (58% of the CPI basket) remained sticky above 9% as we expected.

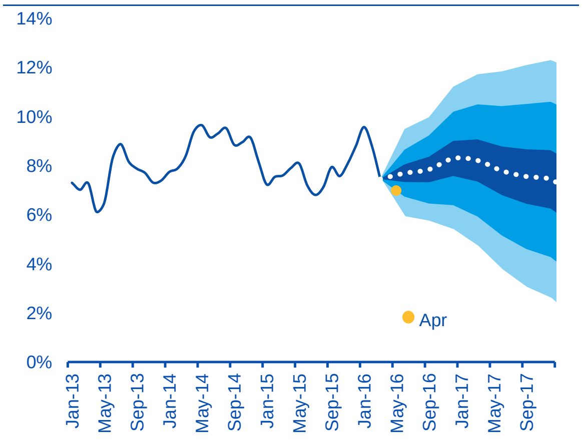
Although FX pass-thru has modestly declined, little margin for currency appreciation, cost push impacts of the minimum wage hike and narrowing output gap will restrain any significant correction in core inflation, in our view. Besides, although lower than previously expected, non-core inflation is expected to go higher starting from May, mainly due to the reversal of base effects on food prices. Reflecting the sharp fall in food inflation, we reduced our year end headline CPI inflation forecast to 8.5% from the previous 9%. Stickiness in the core component prevents us from being optimistic on the inflation front in the medium run.

Figure 3.11
Turkey: GDP forecasts (YoY)



Source: BBVA Research and Garanti Bank

Figure 3.12
Turkey: Inflation forecasts (YoY)



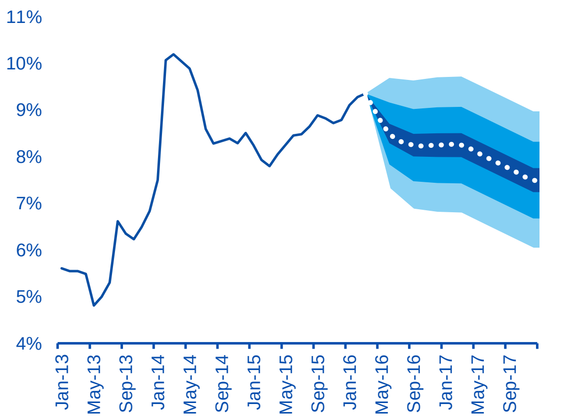
Source: BBVA Research and Garanti Bank

… the speed easing cycle will depend on the external financial conditions.

The CBRT will be inclined to continue its easing cycle (from the upper limit mainly) as long as the global financial conditions remain supportive as complacency about inflation will continue within the New Monetary Policy Committee, in our view. Although according to our latest monthly GDP indicator economic growth is running around 4% (close to its potential), FX adjusted loan growth runs below the CBRT's 15% threshold level. As marginal funding rate is the most relevant CBRT interest rate for commercial loan rates, an easing effort is understandable from a pro-growth point of view.

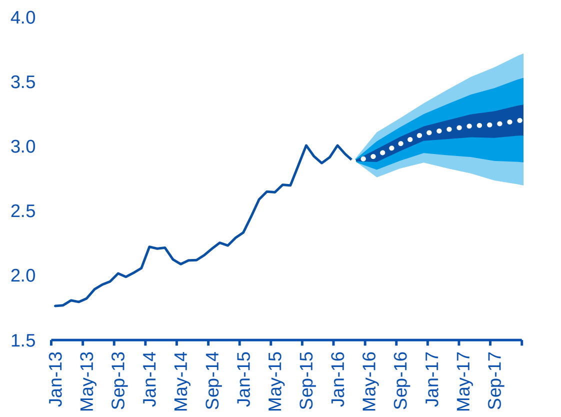
Contrarily, inflation dynamics do not leave much room for further easing. The marked decline in inflation so far (between February and April) was due to depressed energy prices and an extraordinary fall in food prices. Core inflation continues to show stickiness above 9% points, implying that headline inflation may rise again once the favourable base effects die out.

Figure 3.13
Turkey: Official interest rate forecasts (%, CB average funding cost)



Source: BBVA Research and Garanti Bank

Figure 3.14
Turkey: Exchange rate vs USD (USDTRY)



Source: BBVA Research and Garanti Bank

All in all, the CBRT will be eager to continue to narrow the interest rate corridor provided that the global financial conditions and the lira performance allow. As output is close to its potential with core inflation almost doubling the CBRT's official target, our New–Keynesian Philips curve suggests a policy rate above 9%. A persistent complacency to react to additional inflationary pressures may raise further questions regarding the Central Bank's credibility and could trigger a reaction from the markets. Hence, although we do not rule out further cuts in the upper limit of the corridor, the decline in average funding rate will be much more modest as the underlying inflation dynamics continue to call for a tight monetary policy.

Public finance figures will remain as key for maintaining the investment grade

Even though we pencil in some deterioration in budget deficit due to materialisation of pre-election pledges, public debt figures are likely to remain solid as declining interest expenditures will prevent any deterioration. Higher expenditures might be financed mainly by draining the primary surplus, as we expect revenues to remain strong thanks to strong indirect tax collection on domestic consumption.

We forecast budget deficit to GDP ratio to increase to 2% in 2016 from 1.2% last year, mainly on the back of pre-election commitments (i.e the minimum wage and some pension adjustments). On the debt front, we still expect EU defined public debt to GDP ratio to fall to 31.6% this year from 32.9% in 2015. Turkey's solid Public finance figures will remain as key for maintaining the investment grade.

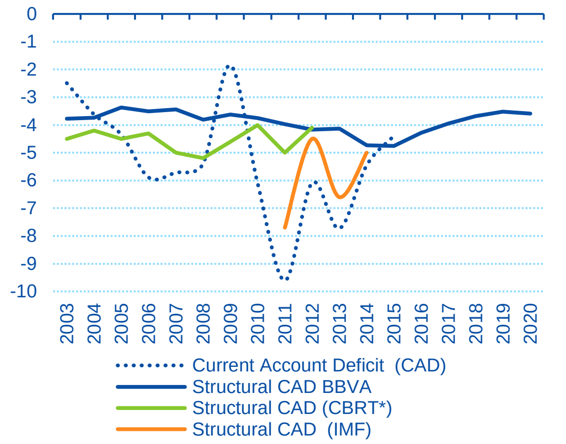
CAD now mostly structural, further adjustments will require reforms

After shrinking to 4.2% of GDP by the end of 1Q16, we expect CAD adjustment to lose pace in 2Q16 due to shrinking tourism revenues in the high season. Hence, **we revise our CAD estimate slightly upwards bearing in mind both the negative impact on tourism and our upward revision in oil prices in 2016. We now expect CAD to be 4.4% of GDP, close to its level of 4.5% at the end of 2015.**

Lagged effects of the decline in energy prices will continue to lower CAD in 2016. After falling by USD 17bn (2.4% of GDP) in 2015, we now expect Turkey's energy bill to decline by another USD 11bn (1.5% of GDP) assuming an average oil price of USD 37 in 2016. Even if recent Brent prices of USD 45 per barrel were to remain throughout 2016, there may be still a gain of USD 8.5bn (1.2% of GDP) this year.

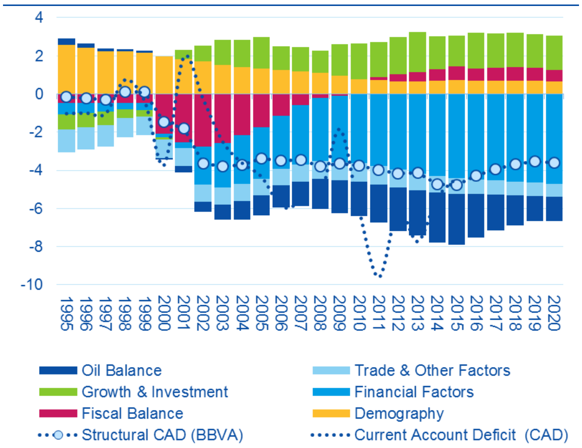
Looking ahead, it will be more difficult to continue the adjustments as more of the current account balance is now structural. **Deepening the adjustment will require progress in the structural reforms to increase the low private saving ratio** (see our Economic watch The oil impact on EM Europe's structural current accounts: a tale of two countries)

Figure 3.15
Turkish Structural Current Account Balance (% of GDP, No Reforms scenario)



Source: BBVA Research and Garanti Bank

Figure 3.16
Structural CAB winners/losers from the oil price (Structural CAB change during 2012-2020 in % of G) (% of GDP)



Source: BBVA Research and Garanti Bank

Table 3.1
Baseline Scenario: Forecast

	2013	2014	2015	2016	2017
GDP (%, y/y)	4.2	3.0	4.0	3.9	3.9
Inflation (%, average)	7.5	8.9	7.7	8.1	7.8
Inflation (%, end of period)	7.4	8.2	8.8	8.5	7.3
Official Interest Rate (%, average)	5.8	9.0	8.4	8.5	7.9
Official Interest Rate (%, end of period)	6.8	8.4	8.8	8.25	7.5
Exchange Rate vs USD (average)	1.9	2.2	2.7	3.0	3.2
Exchange Rate vs USD (end of period)	2.1	2.3	2.9	3.1	3.2
Current Account Balance (% of GDP)	-7.9	-5.4	-4.5	-4.4	-4.3

Source: BBVA Research

4 Balance of Risks

The balance of risks to our baseline scenario for Turkey continued tilted to the negative side given the still fragile situation in the Emerging financial markets, the heightened geopolitical risks in the MENA region and the revival of some political uncertainty. However, there are also risks on the upside coming from the external side, still depressed energy prices continuing to support Turkish current account deficit adjustment and domestic demand through higher disposable income.

The less favourable panorama for emerging markets as a key global risk…

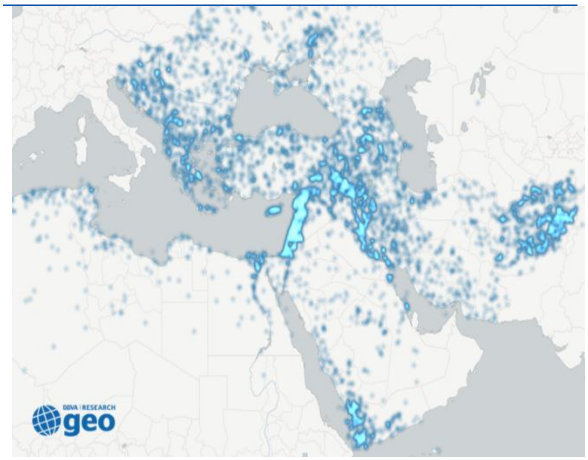
The global scenario and the emerging markets' expected relatively poor performance continue challenging and posing risks on Turkey. Doubts about the effects of the adjustments to China's economy on global trading channels and financing are growing external imbalances, although partially offset by depressed oil prices. Moreover, the standardisation of US monetary policy has gradually started. Although it has not led to any substantial increase in financial volatility until now, it remains a key concern to monitor given its potential to reduce the investor appetite for emerging markets.

… but geopolitical risks will continue to be determinant

The geopolitical risks are still well alive and Turkey's region is not more secure and peaceful than in the previous quarter. **Besides, the proxy wars became more complicated** (Figure 4.1) (see Geo-World: Conflict & Social Unrest January Update):

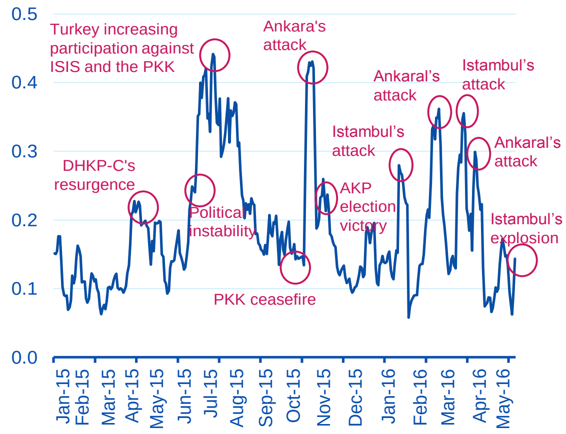
- The Syrian situation is far from solved. Although Russia has withdrawn some portion of its military arsenal from Syria, it enhanced its support to pro-regime forces in order to contain ISIS and also for the Aleppo offensive. The situation on the Turkish border with Syria remains problematic, as well. Thus, the geopolitical atmosphere of the region keeps its heat alive and brings a complex set of choices for Turkey as the country also faces inner political discussions (Figure 4.2).
- Iraq is on the brink of political collapse as the government in Baghdad is about to contain ISIS expansion in the country. The political crisis would definitely constrain Iraq in its war against ISIS (see Iraq: Increasing political tension endangers the future of Iraq).
- On the positive side, Turkey and the EU signed the refugee deal to tackle the most dramatic geopolitical problem in recent history (see The EU and Turkey deal on refugees: a step in the right direction). Moreover, the European Commission gave a green light to visa liberalisation for Turkish citizens in order to honour the refugee deal. However, visa liberalisation depends on the European Parliament's and the EU leaders' decision (see Visa liberalization: A positive step in the EU-Turkey roadmap). We expect the negotiations on this issue to continue

Figure 4.1
BBVA conflict heatmap (Jan 15 - Feb 16) (Number of conflicts / Total events)



Source: www.gdelt.org, BBVA Research and Garanti Bank

Figure 4.2
Turkey: BBVA Conflict Intensity Index (Nov 14 - Feb 16) (Conflict events / Total Events)



Source: www.gdelt.org, BBVA Research and Garanti Bank

The PM Davutoglu Resignation opens new political scenarios…

Uncertainty surrounding the political situation and the security climate has increased. In the coming days Turkey will have a new PM and the system of government may change. Meanwhile the security situation remains tense:

- **A new prime minister and a new constitution:** Prime Minister Ahmet Davutoglu announced that he will leave the AK Party Chair and so the Prime Ministry. This happened due to political differences between PM Davutoglu and the other members of the AK Party board according to PM Davutoglu's farewell speech. The AK Party will hold a leadership congress on May 22 and President Erdogan is expected to appoint the new leader of the party as the next PM without losing any time. **Turkey could have a new government before mid-June**. Meanwhile, an AK Party official announced that they would propose a constitutional amendment in mid-June to raise the non-partisan nature of the President. Because of this, a president can hold his party membership whilst sitting in his presidential chair. **The AK Party will also propose a new constitution supporting executive presidency**. These two changes need the oppositions support as the AK Party lacks 13 more MPs to make constitutional changes in a referendum. The leadership congress in the nationalist MHP and discussions accordingly are important in this sense.

- **The fight against the PKK and ISIS:** Turkey's ongoing fight against the PKK escalated to urban south-eastern cities. The Turkish Security Forces are successful in clearing the towns from the PKK's urban affiliates and relocating some of the city centres to sustain security. Meanwhile **Turkey's firmer stance against ISIS led to ISIS retaliation aiming at large city centres and recently the border city of Kilis.** Turkey strongly damages ISIS units across the border with artillery shelling. For now, Turkey backed moderate rebels are fighting against ISIS on the ground to clear the Manbij Pocket (the area between Marea and Jarabulus – Turkey's two red lines forbidden to PKK affiliated YPG units to cross). However, these rebel fighters are unsuccessful in defeating ISIS and they even lost the border villages they claimed from ISIS. This could lead to more US support to the YPG and that would widen the divergence between Washington and Ankara.

  In summary, domestic political discussions are well alive and the geopolitical situation is still far from solved. Nevertheless, the rapprochement between the EU and Turkey could provide further room to manoeuvre in the international arena.

5 Tables

Table 5.1

Macroeconomic Forecasts: Gross Domestic Product

(Annual average, %)	2012	2013	2014	2015	2016	2017
United States	2.2	1.5	2.4	2.4	2.5	2.4
Eurozone	-0.8	-0.2	0.9	1.5	1.6	1.9
Germany	0.6	0.4	1.6	1.4	1.7	1.8
France	0.2	0.7	0.2	1.2	1.3	1.6
Italy	-2.8	-1.8	-0.3	0.6	1.0	1.4
Spain	-2.6	-1.7	1.4	3.2	2.7	2.7
United Kingdom	1.2	2.2	2.9	2.3	1.8	1.9
Latam *	2.9	2.6	0.7	-0.5	-1.0	1.7
Mexico	4.0	1.4	2.1	2.4	2.2	2.6
Brazil	1.9	3.0	0.1	-3.9	-3.0	0.9
Eagles **	5.8	5.5	5.2	4.6	4.7	4.9
Turkey	2.1	4.2	3.0	4.0	3.9	3.9
Asia Pacific	5.8	5.8	5.6	5.5	5.3	5.1
Japan	1.7	1.5	0.0	0.5	0.8	0.8
China	7.7	7.7	7.3	6.9	6.4	5.8
Asia (ex. China)	4.3	4.3	4.2	4.3	4.4	4.5
World	3.4	3.3	3.4	3.1	3.2	3.4

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.2

Macroeconomic Forecasts: Inflation

(Annual average, %)	2012	2013	2014	2015	2016	2017
United States	2.1	1.5	1.6	0.1	1.3	2.0
Eurozone	2.5	1.4	0.4	0.0	0.2	1.3
Germany	2.1	1.6	0.8	0.1	0.0	1.2
France	2.2	1.0	0.6	0.1	0.1	1.3
Italy	3.3	1.2	0.2	0.1	0.1	1.3
Spain	2.4	1.4	-0.2	-0.5	-0.3	1.7
United Kingdom	2.8	2.6	1.5	0.1	0.7	1.6
Latam *	7.8	9.2	12.7	17.5	32.9	34.4
Mexico	4.1	3.8	4.0	2.7	2.8	3.1
Brazil	5.4	6.2	6.3	9.0	8.6	5.2
Eagles **	5.1	5.2	4.5	4.4	4.2	4.1
Turkey	8.9	7.5	8.9	7.7	8.1	7.8
Asia Pacific	3.8	4.0	3.3	2.2	2.7	3.1
Japan	0.0	1.6	2.7	0.8	0.7	1.5
China	2.6	2.6	2.0	1.4	2.3	2.7
Asia (ex. China)	4.7	5.1	4.4	2.9	3.0	3.5
World	4.4	4.2	3.9	3.8	5.0	5.4

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.3

Macroeconomic Forecasts: Current Account

(Annual average, % GDP)	2012	2013	2014	2015	2016	2017
United States	-2.8	-2.3	-2.9	-2.7	-3.0	-3.2
Eurozone	1.3	2.1	2.5	3.2	3.2	3.0
Germany	7.1	6.8	7.4	8.6	8.0	7.2
France	-1.2	-0.8	-0.9	-0.2	-0.3	0.0
Italy	-0.4	0.9	1.9	2.2	2.6	2.5
Spain	-0.2	1.5	1.0	1.4	2.1	2.5
United Kingdom	-3.3	-4.5	-5.1	-5.2	-5.4	-5.5
Latam *	-1.9	-2.6	-2.9	-3.5	-3.7	-2.5
Mexico	-1.3	-2.4	-1.9	-2.8	-3.1	-3.2
Brazil	-3.0	-3.1	-4.3	-3.4	-2.1	-1.0
Eagles **	0.9	0.5	0.6	0.7	0.5	0.7
Turkey	-6.2	-7.9	-5.4	-4.5	-4.4	-4.3
Asia Pacific	1.1	1.3	1.7	2.6	2.1	1.9
Japan	1.0	0.7	0.5	3.3	3.0	2.6
China	2.6	2.0	2.1	3.1	2.4	2.3
Asia (ex. China)	-0.1	0.7	1.4	2.3	1.9	1.5

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.4

Macroeconomic Forecasts: Government Balance

(Annual average, % GDP)	2012	2013	2014	2015	2016	2017
United States	-6.8	-4.1	-2.8	-2.7	-3.0	-3.0
Eurozone	-3.7	-3.0	-2.6	-2.1	-1.9	-1.6
Germany	-0.1	-0.1	0.3	0.7	0.0	0.3
France	-4.8	-4.0	-4.0	-3.5	-3.4	-3.0
Italy	-2.9	-2.9	-3.0	-2.6	-2.3	-1.5
Spain	-6.8	-6.6	-5.8	-5.0	-3.9	-2.7
United Kingdom	-8.4	-5.7	-5.6	-4.3	-3.4	-2.2
Latam *	-2.3	-2.3	-4.2	-6.0	-5.3	-4.5
Mexico	-2.6	-2.3	-3.2	-3.5	-3.0	-2.5
Brazil	-2.5	-3.0	-6.7	-10.2	-9.0	-7.3
Eagles **	-1.4	-2.0	-2.7	-4.8	-4.6	-3.9
Turkey	-2.0	-1.2	-1.3	-1.2	-2.0	-1.9
Asia Pacific	-2.6	-2.9	-2.8	-3.5	-3.6	-3.1
Japan	-7.6	-9.2	-7.9	-6.7	-6.0	-5.5
China	-1.1	-1.5	-1.8	-3.5	-4.0	-3.5
Asia (ex. China)	-3.8	-4.1	-3.7	-3.6	-3.2	-2.8

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.5
Macroeconomic Forecasts: 10-year government bond yield

Annual Average, %	2012	2013	2014	2015	2016	2017
United States	1.79	2.34	2.53	2.13	2.02	2.49
Germany	1.57	1.63	1.25	0.54	0.47	0.75

Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.6
Macroeconomic Forecasts: Exchange Rates

Annual Average	2012	2013	2014	2015	2016	2017
USD-EUR	0.78	0.75	0.75	0.90	0.91	0.89
EUR-USD	1.29	1.33	1.33	1.11	1.10	1.12
GBP-USD	1.59	1.56	1.65	1.53	1.49	1.66
USD-JPY	79.77	97.45	105.82	121.07	118.44	128.50
USD-CNY	6.31	6.20	6.14	6.23	6.63	6.99

Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.7
Macroeconomic Forecasts: Official Interest Rates

End of period, %	2012	2013	2014	2015	2016	2017
United States	0.25	0.25	0.25	0.50	1.00	2.00
Eurozone	0.75	0.25	0.05	0.05	0.00	0.00
China	6.00	6.00	5.60	4.35	4.10	3.60

Forecast closing date: 6 May 2016.
Source: BBVA Research and IMF

Table 5.8
Baseline Scenario: Forecast

	2013	2014	2015	2016	2017
GDP (%, y/y)	4.2	3.0	4.0	3.9	3.9
Inflation (%, average)	7.5	8.9	7.7	8.1	7.8
Inflation (%, end of period)	7.4	8.2	8.8	8.5	7.3
Official Interest Rate (%, average)	5.8	9.0	8.4	8.5	7.9
Official Interest Rate (%, end of period)	6.8	8.4	8.8	8.25	7.5
Exchange Rate vs USD (average)	1.9	2.2	2.7	3.0	3.2
Exchange Rate vs USD (end of period)	2.1	2.3	2.9	3.1	3.2
Current Account Balance (% of GDP)	-7.9	-5.4	-4.5	-4.4	-4.3

Source: BBVA Research

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