

Turkey Economic Outlook Fourth Quarter

BBVA Research

October 2017



Key messages

1. Global recovery proceeds at a stable pace, increasingly synchronized across large regions though inflation pressures remain contained
2. Thanks to the Credit Guarantee Fund (CGF), the Turkish economy continues to grow above potential, which leads us to upgrade our 2017 GDP growth estimate by 1pp to 6%
3. Higher momentum in economic activity and ongoing exchange rate pass-through especially from Euro results in a higher inflation path
4. The Central Bank of Turkey will remain tight for longer to restore credibility and contain inflationary pressures. We expect fiscal policy to remain supportive ahead of the elections in 2019
5. We expect current account deficit not to deteriorate excessively as the recovery in tourism revenues will buffer the higher import growth.

* Please check the following links for the detailed analysis of [the Impact of the Credit Guarantee Fund on the Economy](#) and [the Sentiment on the Central Bank](#)

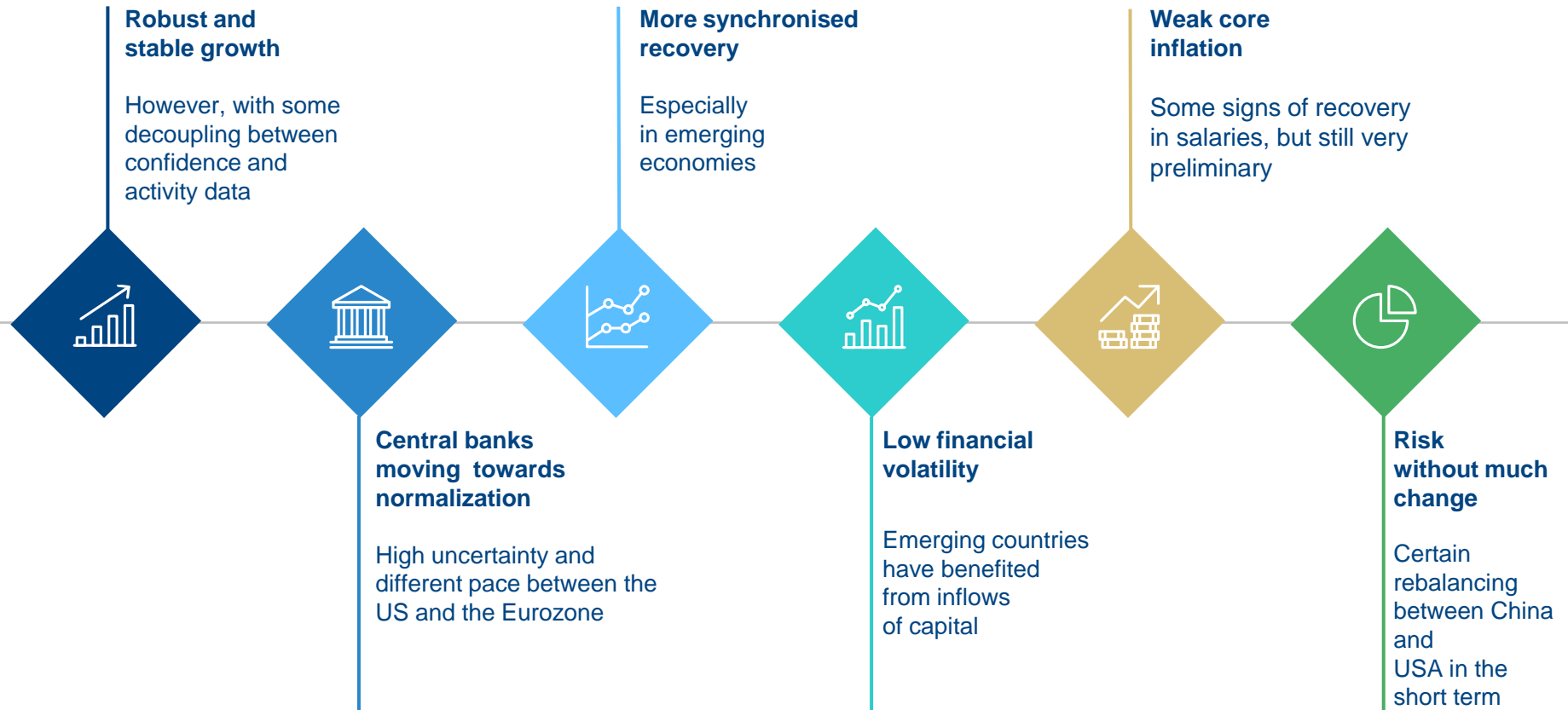


GLOBAL

Robust, stable and
synchronized global growth

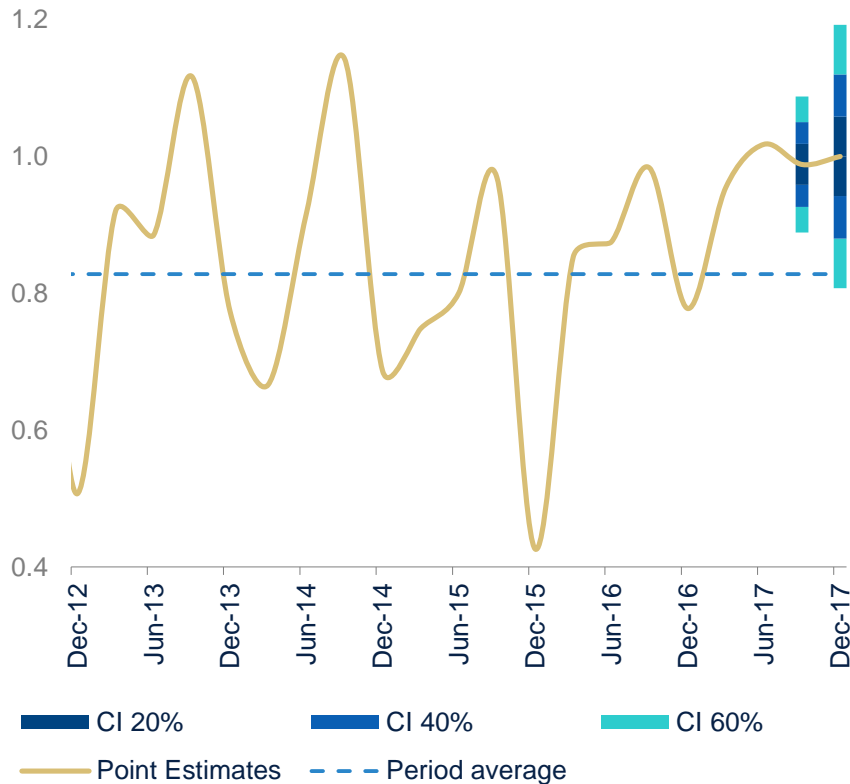


The positive global environment is consolidated

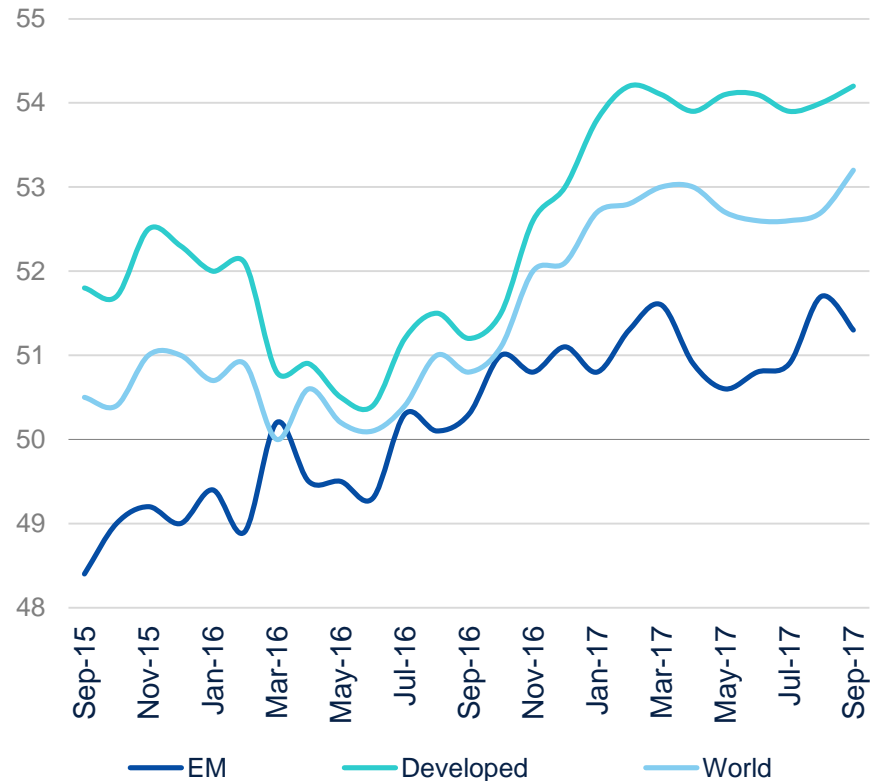


Global GDP accelerated slightly in 2Q17 while recent data suggest that it could maintain its dynamism in 2H17

World GDP Growth
forecasts based on BBVA-GAIN (% , QoQ)

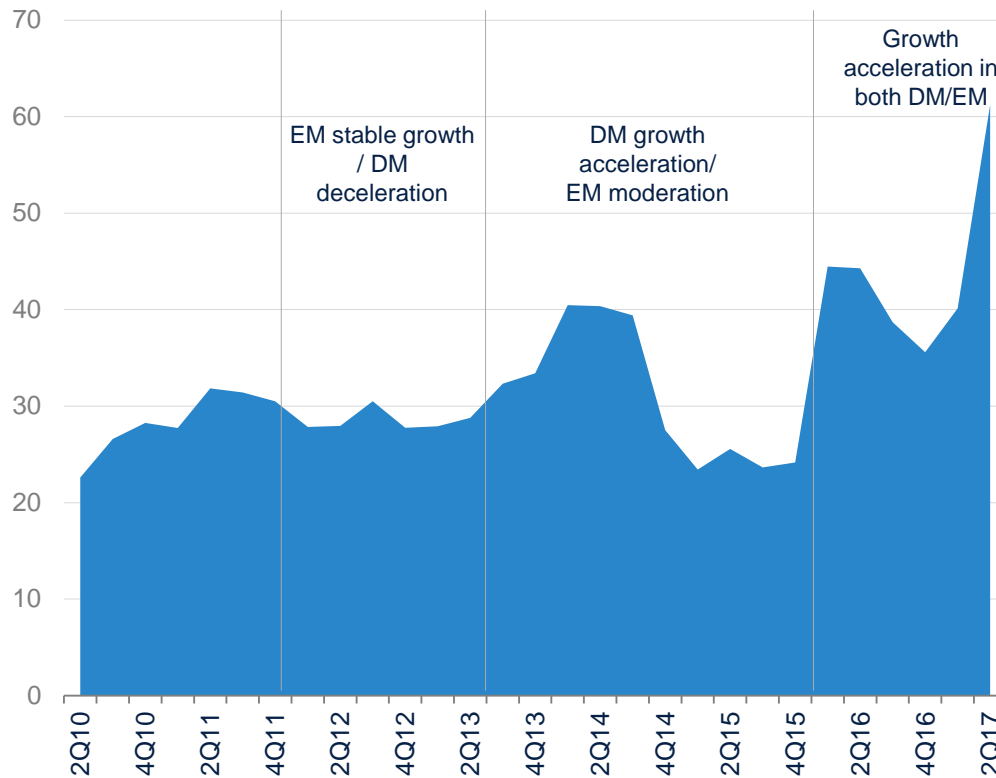


World Manufacturing PMI
Level



The current recovery is more synchronized across different areas

Index of growth synchronization between developed and emerging economies



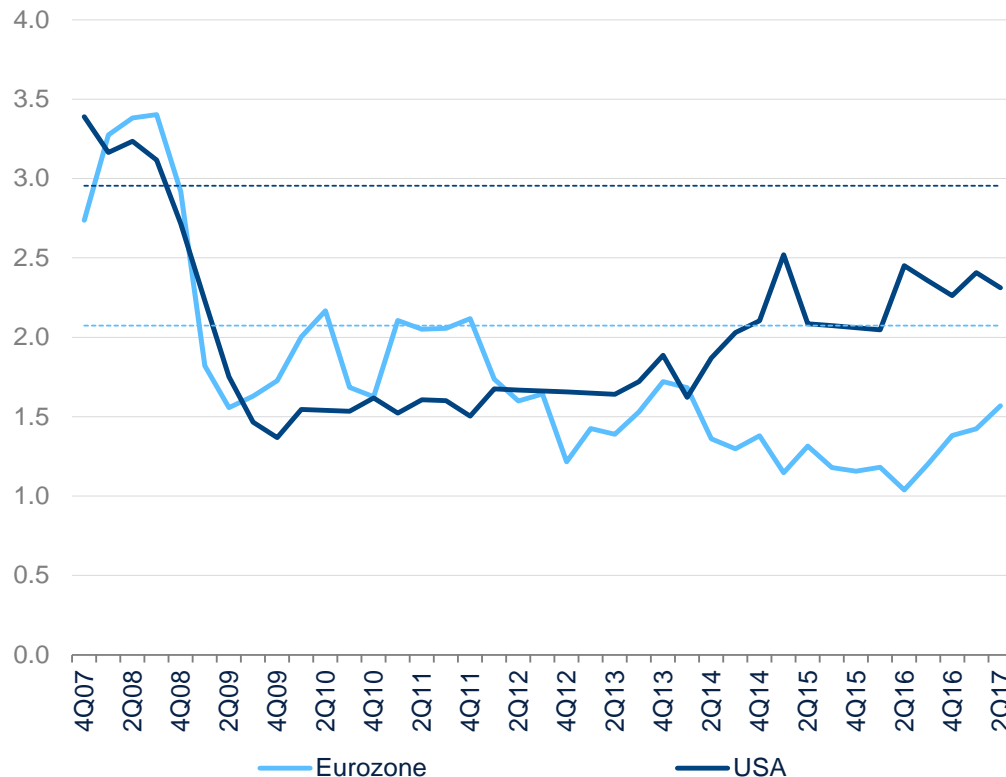
- ◆ Developed (DM)
 - Significant growth rebound in the US
 - Positive surprise in Europe
- ◆ Emerging (EM)
 - Small deceleration in China, although smaller than expected, still supporting the rest of Asia
 - Recovery in other emerging regions, such as Russia and Latin America
- ◆ Growth increasingly supported by economic policies

Index of synchronization: result of inverting the standard deviation of the quarterly growth observed in the countries. In this way, the index associates smaller (greater) volatility in the growth among countries with a greater (lesser) degree of synchronization at world level.

Sources: Markit Economics and BBVA Research

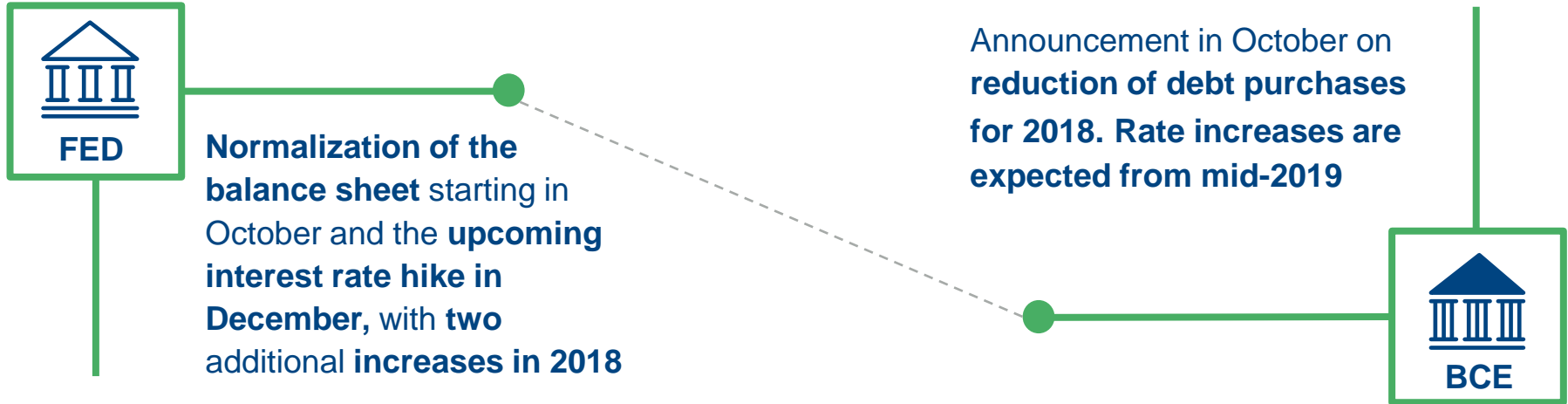
Core inflation dynamics still do not show any warning signal

USA and Eurozone: Wages
(YoY %)



- ◆ Despite economic growth and the improvement in the labor market, **core inflation remains at relatively low levels**
- ◆ **Uncertainty** as to whether the inflation determinants temporary or permanent
- ◆ **Cautious central banks**, especially in developed countries. More margin in emerging economies

Central banks: progress towards very gradual normalization



High level of uncertainty

- In the US, due to the moderation of inflation and the expected change in the FOMC in 2018



- In the **Eurozone**, a bias toward more gradual tapering (strength of the euro) and a lag in the cycle of rate hikes (low inflation)

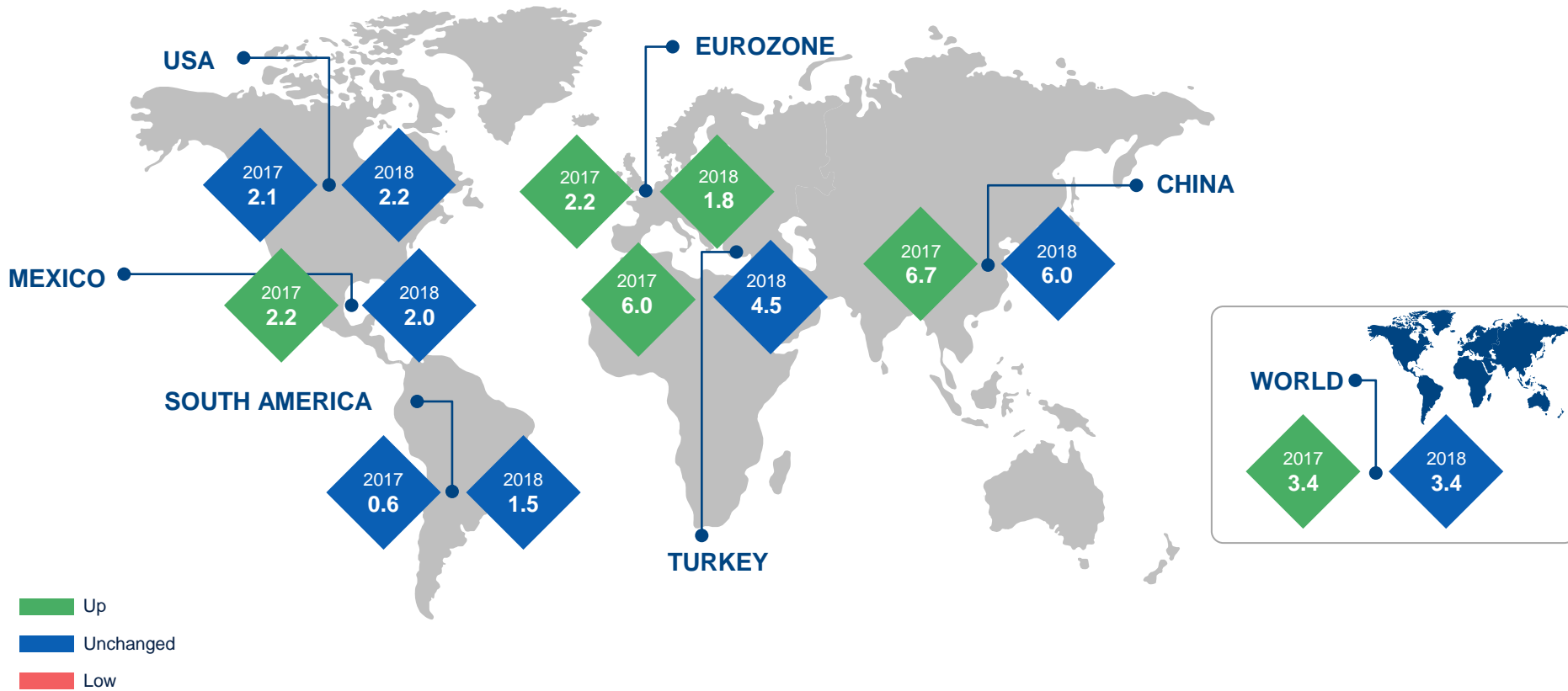
Financial markets: still favoring emerging economies

Indicator of regional relocation of assets
(standard deviation from the historical average)



- ◆ Weakness of the dollar and comparatively poor US bond yields boost the quest for profitability and bolster assets in emerging markets
- ◆ Global liquidity will remain high, given the gradual process of normalization by the Fed and the ECB, although these tailwinds will disappear

Upward revision for Europe and China, positive bias in South America



Turkish Economy

Strong Growth and High
Inflation

The economic effects of the
Credit Guarantee Fund
(CGF)

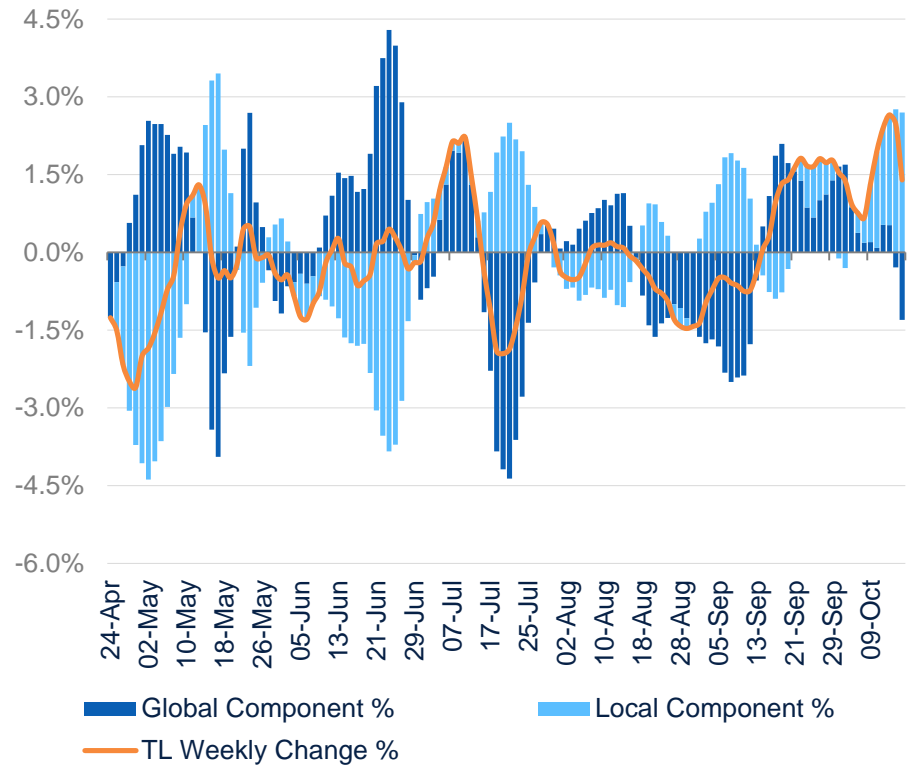


The exchange rate moves with some ups & downs related to global and geopolitical factors

Turkish Lira vs US Dollar
(Level)

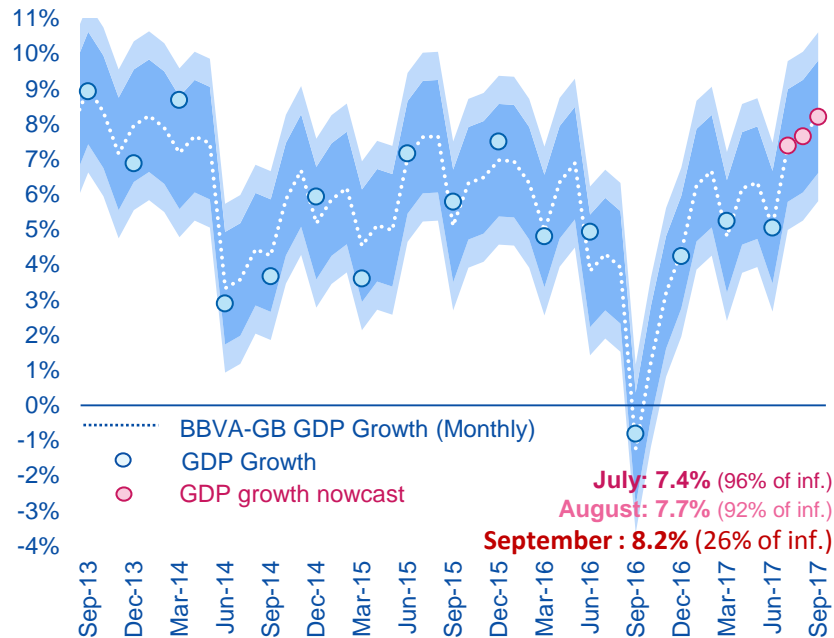


Turkish Lira: Global and Local Factors
(weekly change)

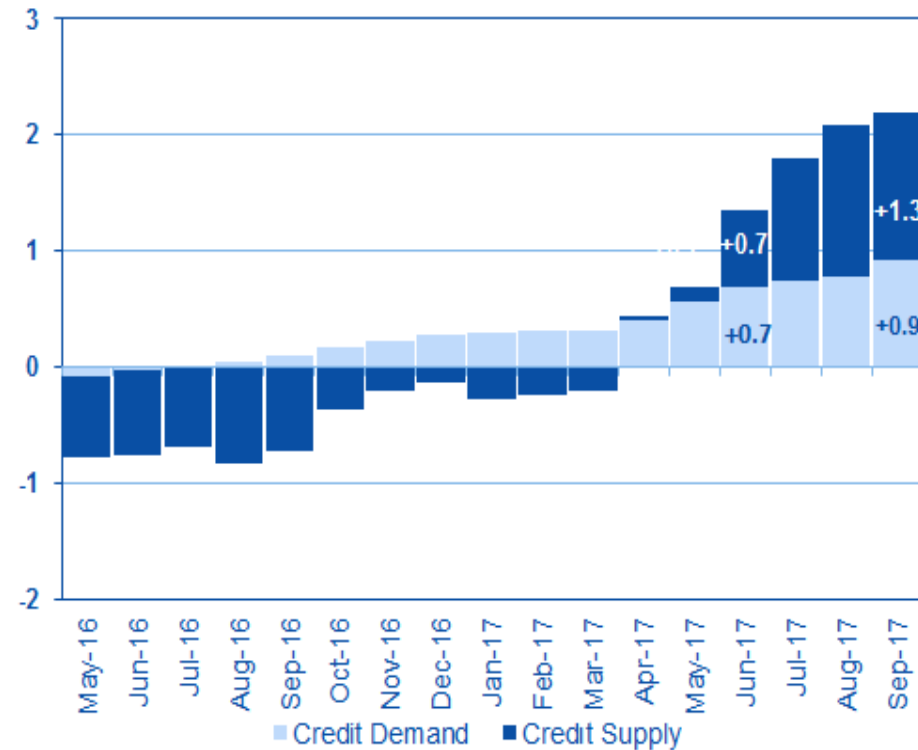


The GDP growth confirmed its robustness (2Q) with some extra impulse coming from the Credit Guarantee Fund (CGF) “supply shock”

Monthly GDP Growth Indicator & Nowcast
(YoY Change, %)



Contribution of the CGF to GDP Growth*
(pp)



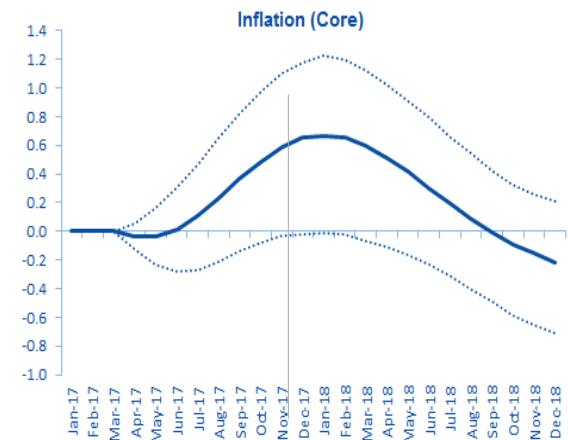
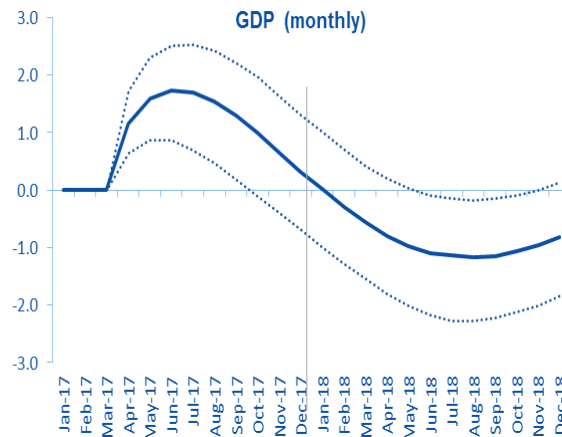
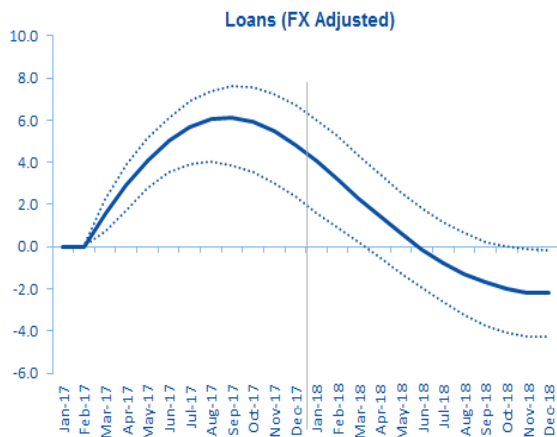
Source: BBVA Research, Bloomberg

* See the detailed analysis in the following [link](#)

The Credit Guarantee Fund has proved to be an efficient counter-cyclical tool, but it is not a “free lunch”

The Effects of a “Credit Supply Shock” to the economy*

(Shock of CGF, 5 times standard deviation in loans shock. Variables in 3-Month Moving Average)



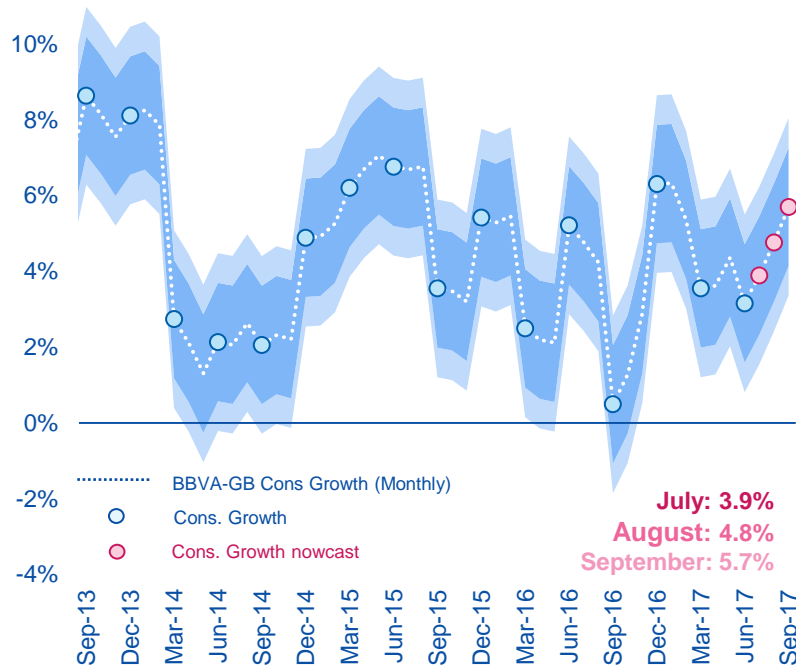
- ◆ The CGF has a **positive but temporary effect on growth**, with a somewhat **delayed effect on inflation** once demand kicks in
- ◆ Once the positive impact on growth fades, the **challenge for the government is how to maintain the impulse**

Source: BBVA Research,

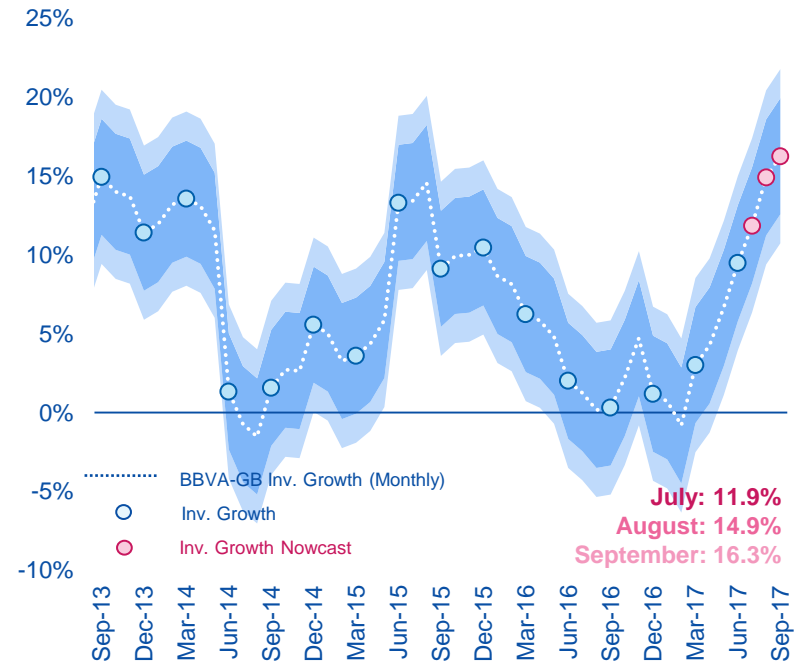
* See the detailed analysis in the following [link](#)

Credit related items as durables consumption and construction investment have been particularly benefited by the countercyclical measures

Monthly Consumption Nowcast (YoY Change, %)

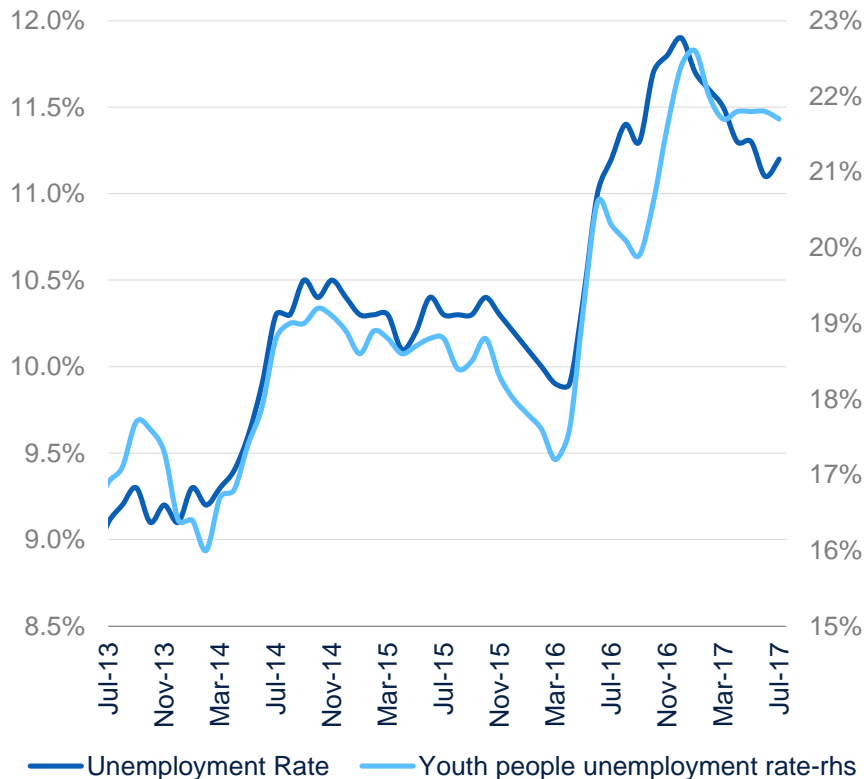


Monthly Investment Nowcast (YoY Change, %)

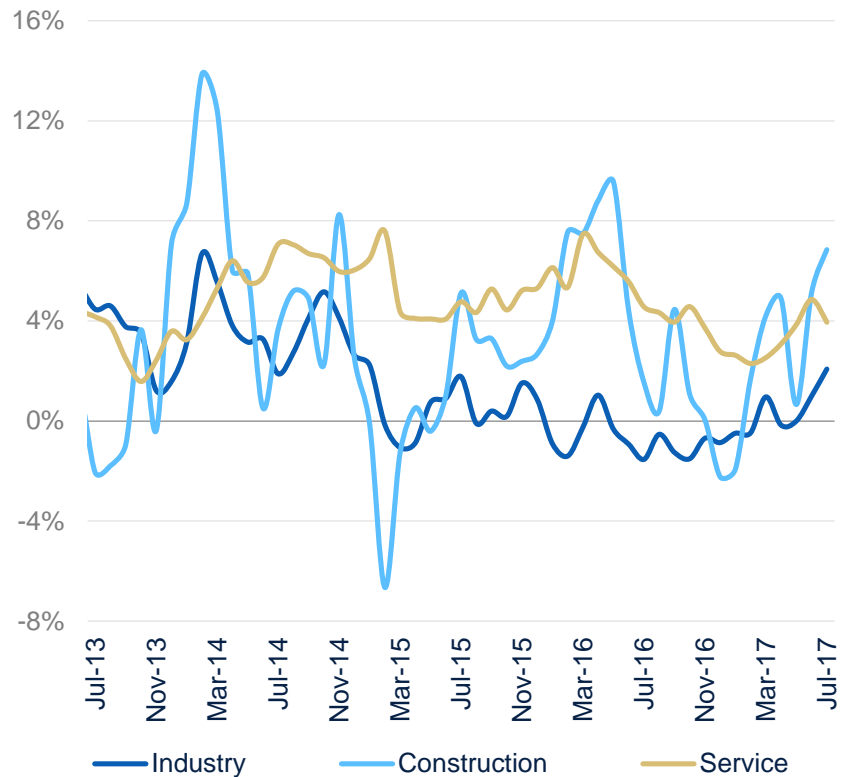


Employment is lagging behind but will be improving gradually once demand response starts to accelerate

Unemployment Rate
(SA, %)

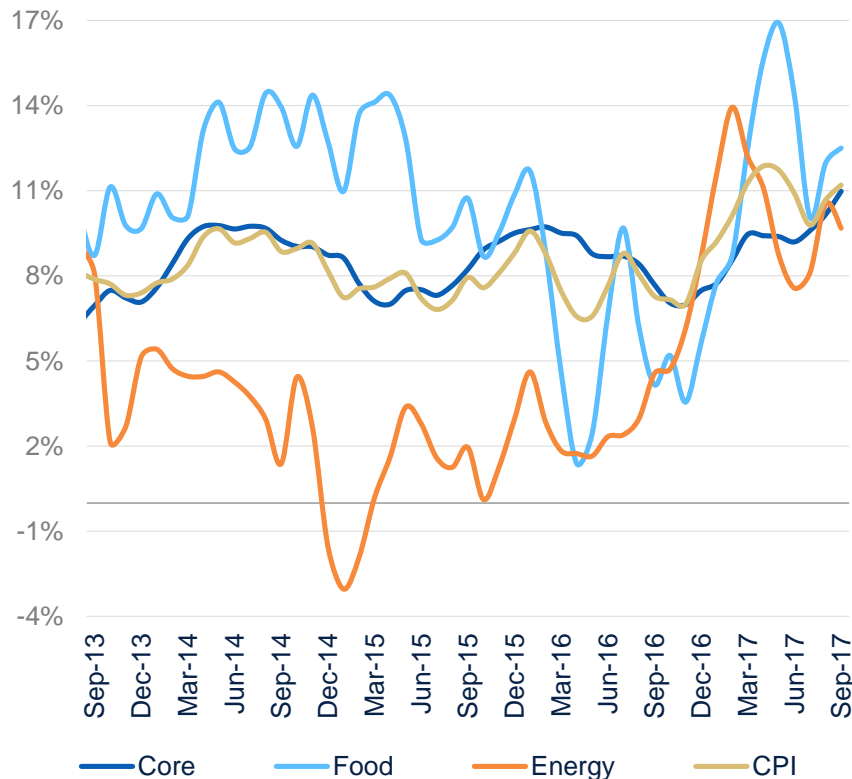


Employment Growth in Sectors
(YoY)

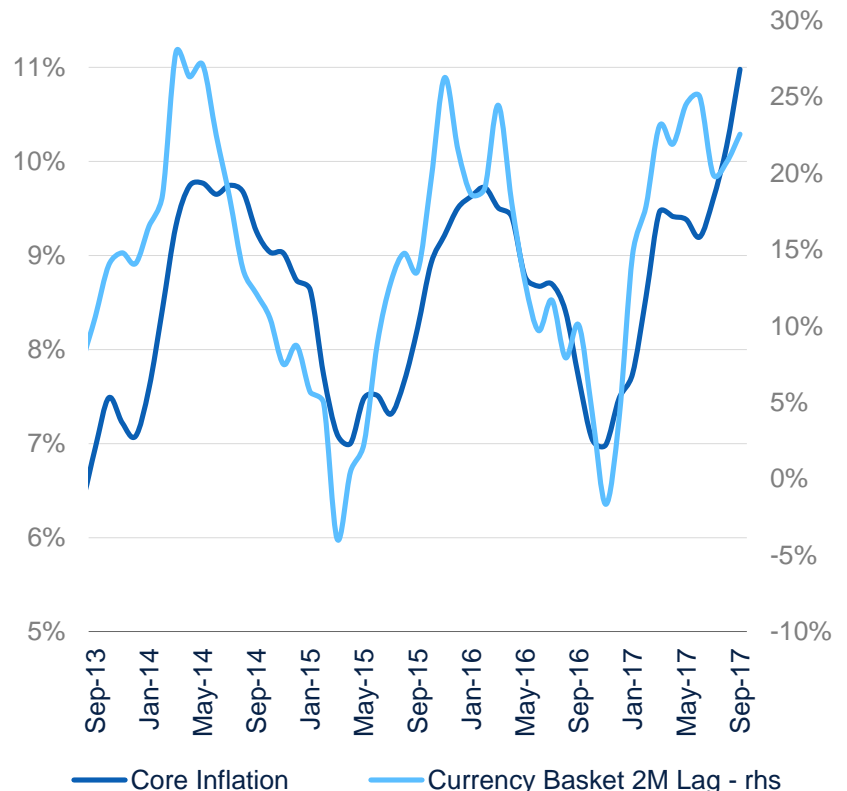


Inflation has been recently showing negative surprises, especially on core items. Strong growth and the exchange rate depreciation against Euro are hitting the core inflation

CPI Inflation & Its Components
(YoY)

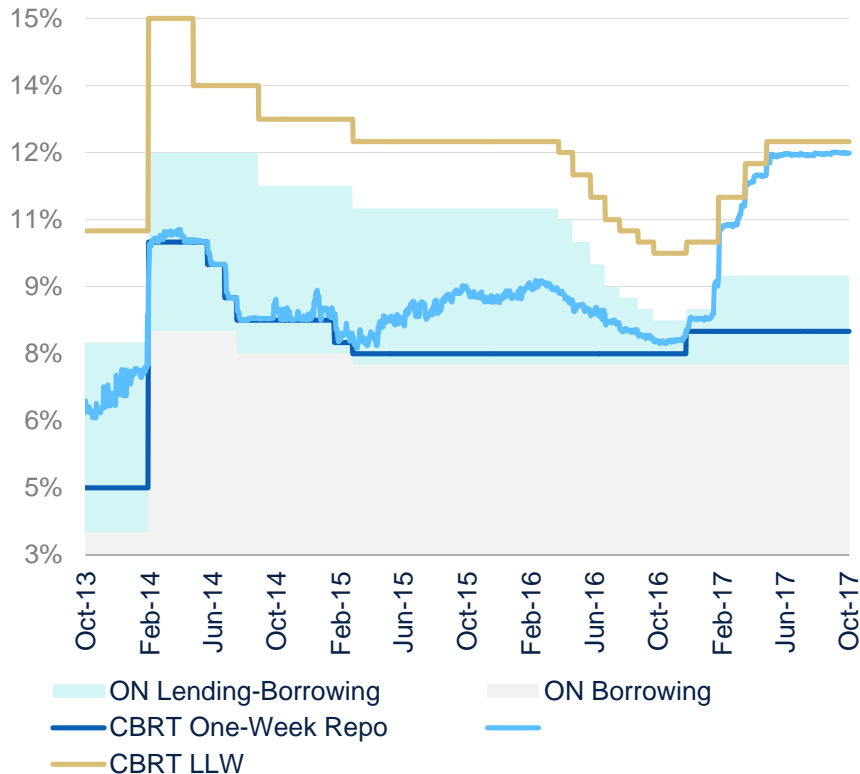


Core Inflation & Currency Basket
(YoY)

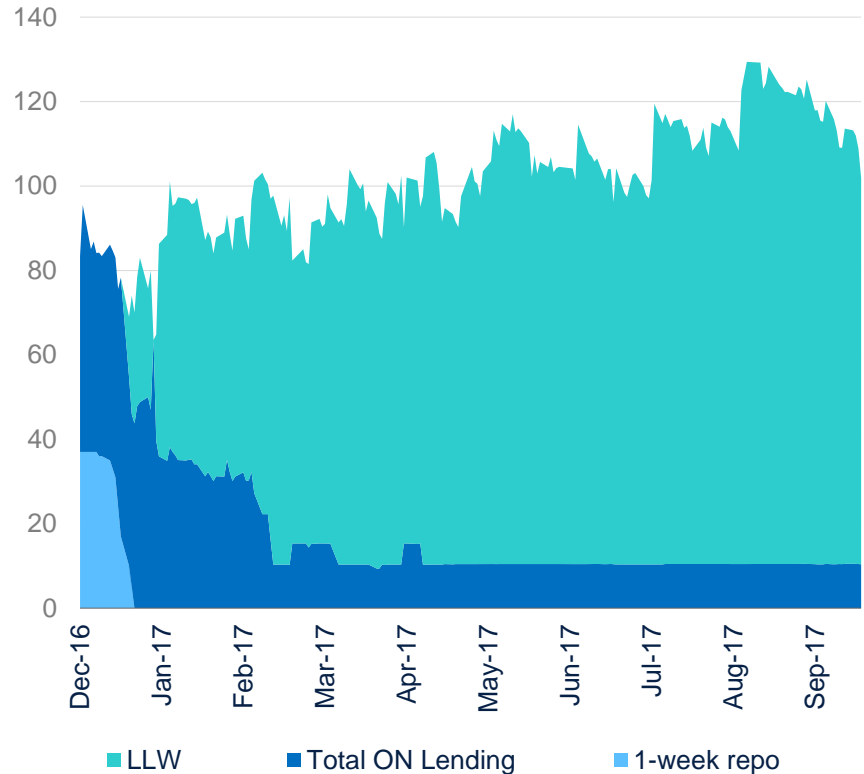


Fortunately, The Central Bank (CBRT) has remained tight by continuing to rely on the Late Liquidity Window (LLW)

CBRT Interest Rate Corridor
(Annual Level, %)

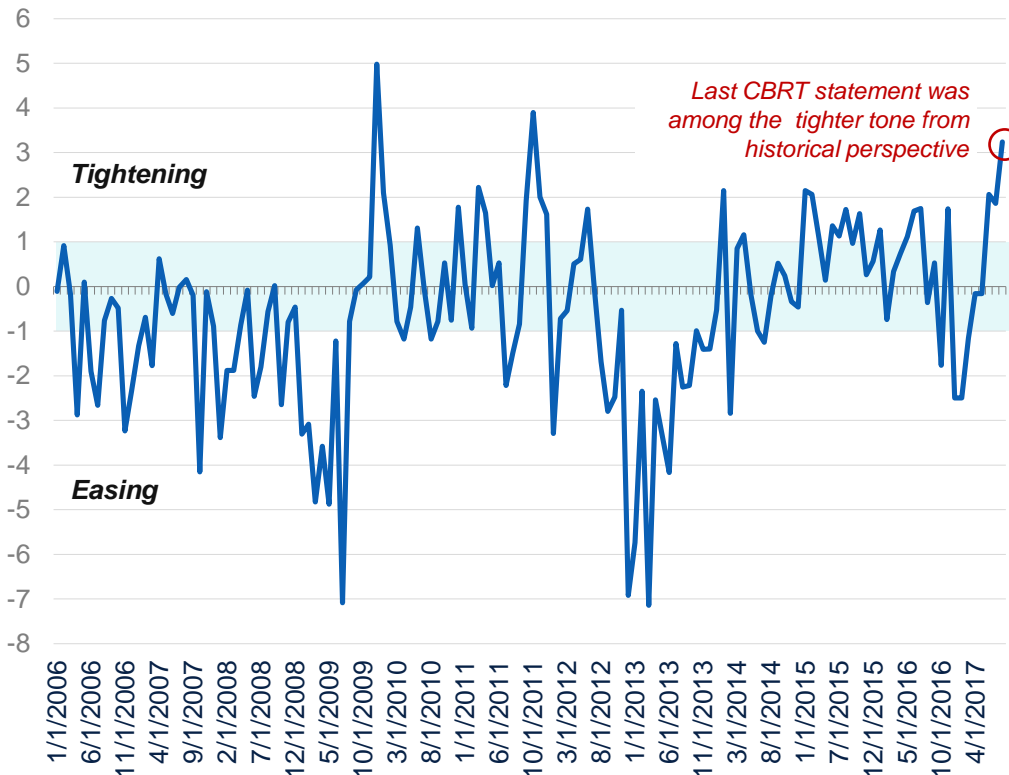


CBRT Funding Allocation
(Bn TL)



The CBRT stays firm, somewhat forwarding the market to «tighter for longer» in its policy reports and wording...

CBRT Monetary Policy Sentiment in Minutes*
(Standardized, estimated through Big Data LDA Techniques from Minutes & Statements)



- ◆ The CBRT will maintain its tight stance for longer in order to help the exchange rate depreciate only smoothly ahead of the Global Central Banks' normalization process
- ◆ Difficulties to curb inflation (Government's MTP assumes above potential growth rates in the next 3 years) and intense geopolitical environment prove to be the main risks on monetary policy

Word Clouds of some of the estimated topics*

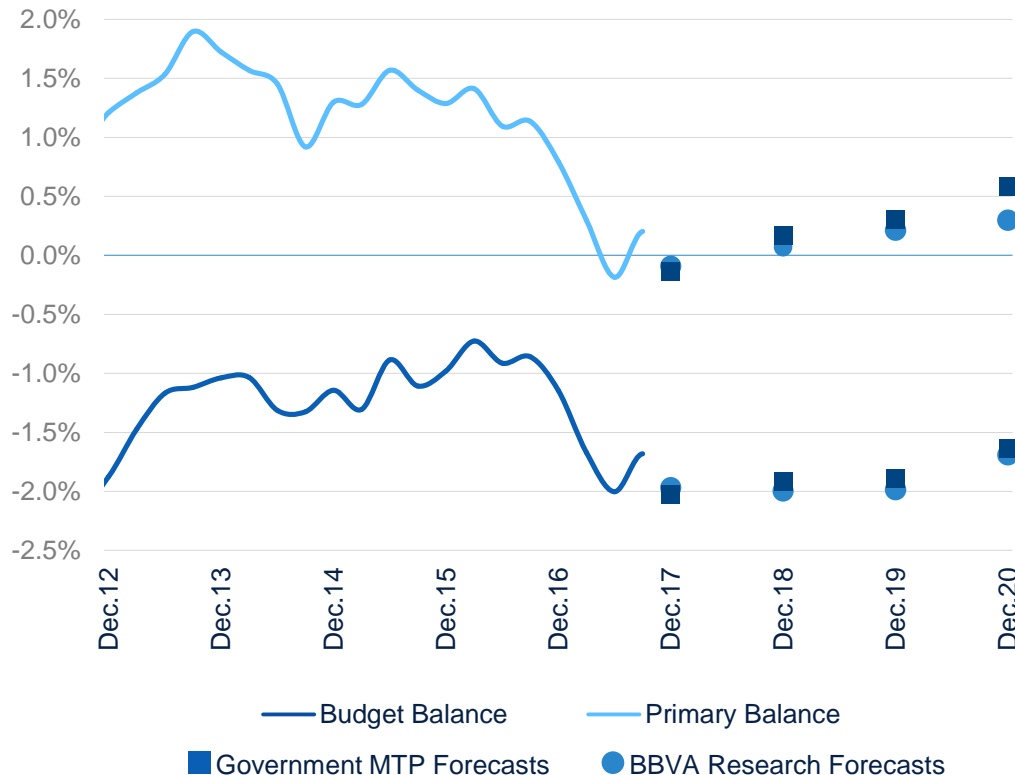


Source: BBVA Research

See the detailed analysis at the following [link](#)

The Government also contributed with countercyclical fiscal policy, but should start to normalize fiscal policy soon

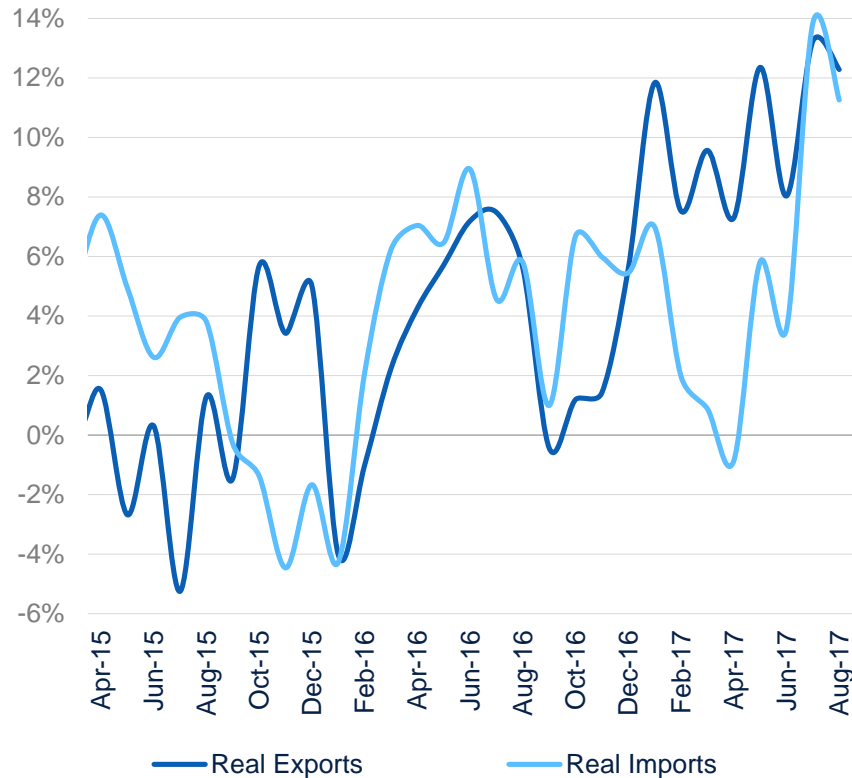
Budget and Primary Balance (% GDP, *3Q GDP data is a forecast)



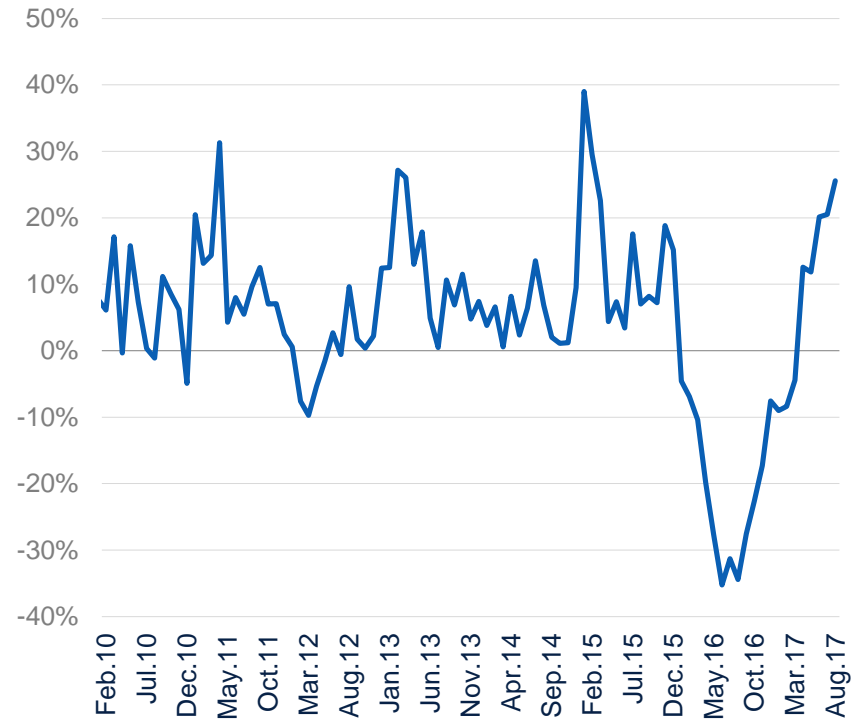
- ◆ The Government foresees supportive fiscal measures to continue in the next 3 years (MTP), engaged with solid revenues on top of high economic growth and recent tax hikes to finance increasing defense & security expenses
- ◆ Our expectation is a slightly worse evolution of budget deficit as we forecast GDP growth lower compared to the above potential estimate levels of the Government in the medium term

The external sector has been supportive and tourism figures are recovering...this will buffer the recent increase in imports

Foreign Trade Volumes
(3MA YoY)



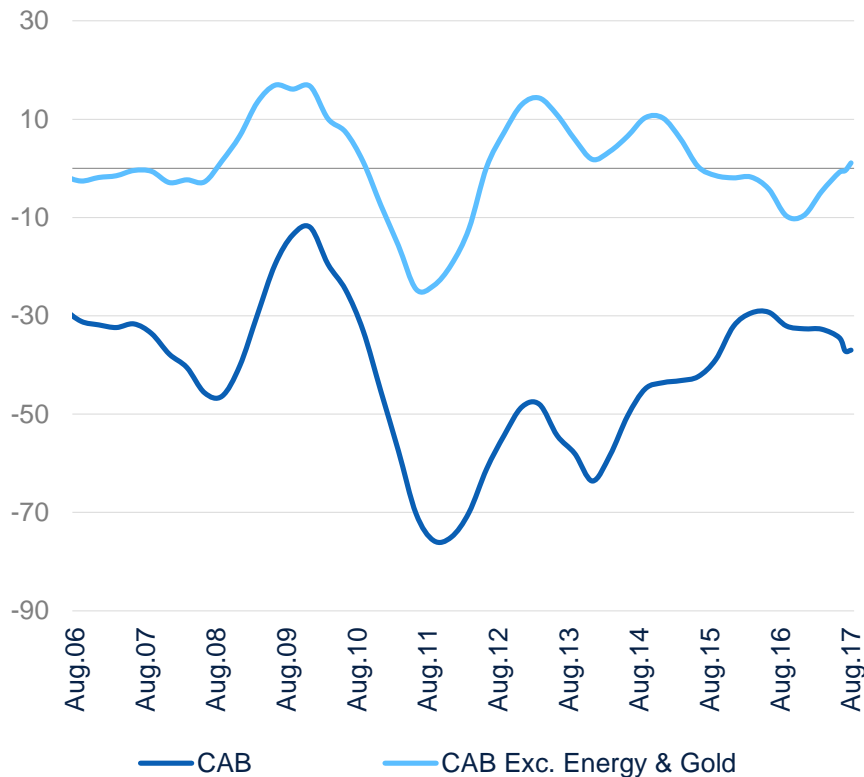
Number of Tourists
(YoY)



Only a marginal deterioration in current account balance is expected thanks to the recovery in tourism revenues. Portfolio flows have been gaining momentum in the financing side

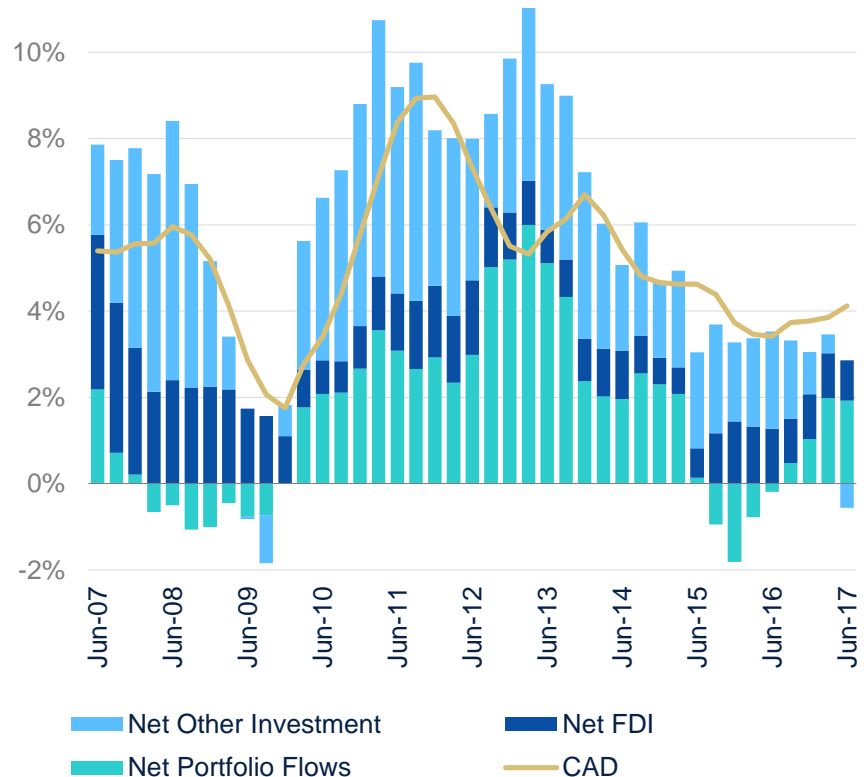
Current Account Balance

(12M sum, bn USD)



Current Account Financing

(12M sum, % GDP)



Turkey

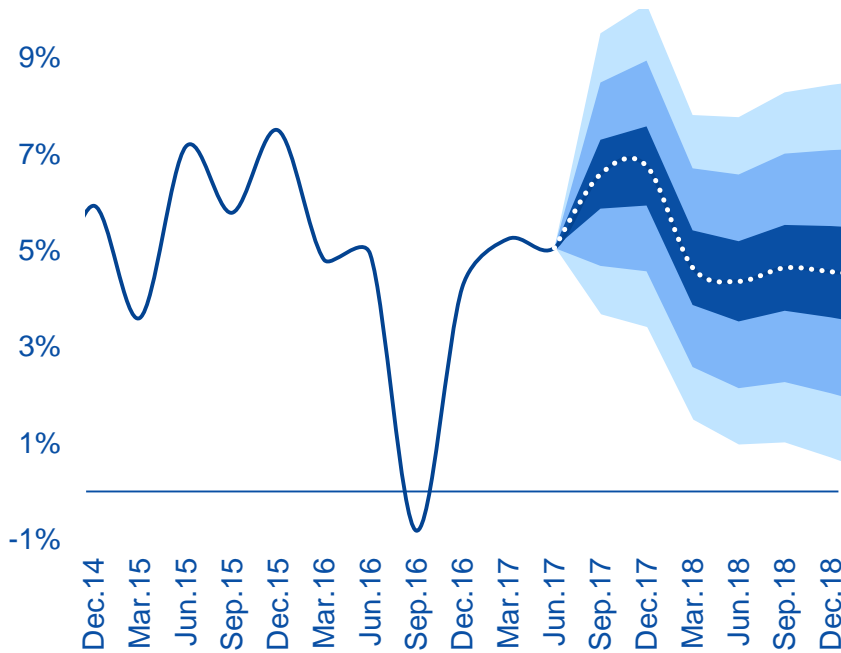
The Baseline Scenario



Economic growth will be higher as inflation...

GDP Forecasts

(YoY Baseline scenario)

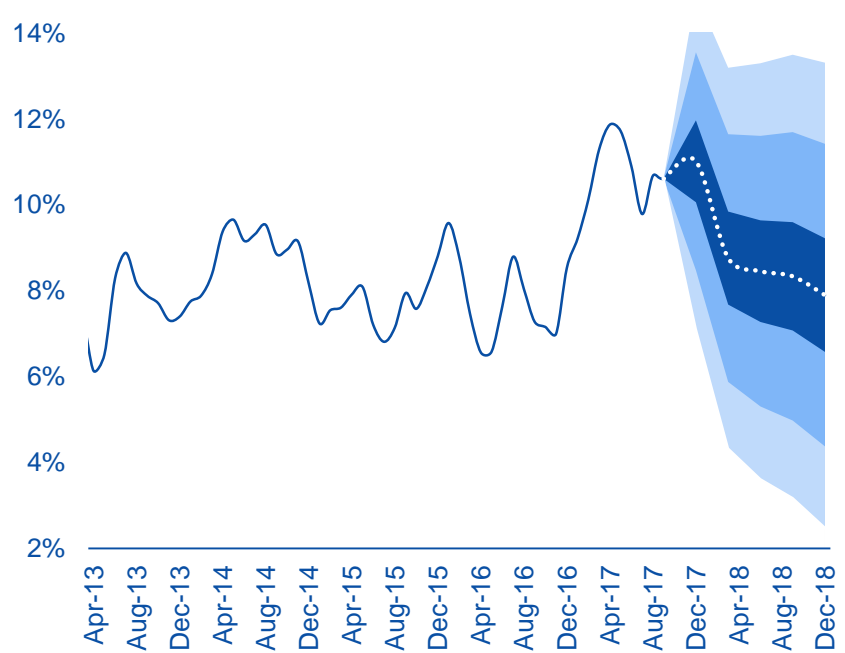


Source: BBVA - Garanti Research Models

We revise our 2017 GDP growth estimate by 1pp to 6% on positive impulses of the CGF. We maintain our forecast at 4.5% for 2018

Inflation Forecasts

(3MA YoY baseline scenario)

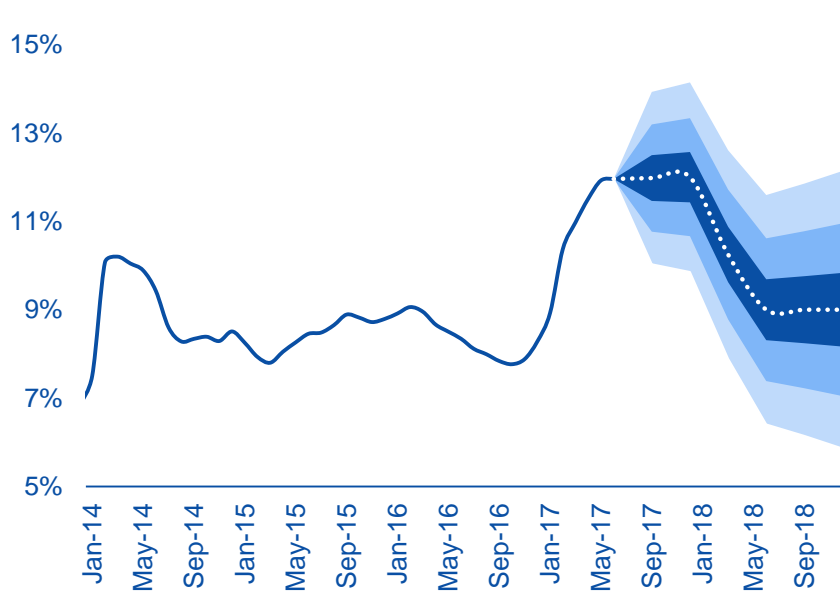


Stronger demand and the appreciation of Euro weigh on the core inflation outlook; hence, we upgrade our 2017 year-end inflation to 10%

The CBRT will maintain the tight monetary policy for longer, supporting the exchange rate performance

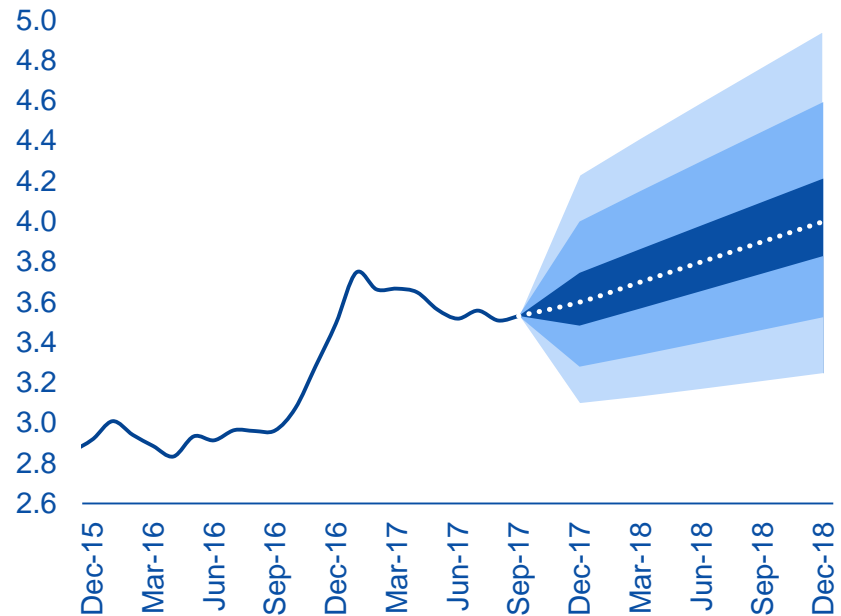
Average Funding Rate Forecasts

(% Baseline scenario)



Exchange Rate Forecasts

(USDTRY Level baseline scenario)



Source: CBRT and Garanti Research Models

Relatively higher inflation path will require the Central Bank to stay tight for longer. We initially thought that the Bank could ease up once inflation starts to recede

The exchange rate will depreciate more gradually as global pressures will be compensated by a tighter than expected monetary policy

Baseline forecasts

	2015	2016	2017f	2018f
GDP (%)	6.1%	3.2%	6.0%	4.5%
<i>Private consumption(%)</i>	5.4%	3.7%	4.5%	4.0%
<i>Public consumption (%)</i>	3.9%	9.5%	4.4%	5.1%
<i>Gross fixed investment (%)</i>	9.3%	2.2%	6.2%	5.2%
<i>Exports (%)</i>	4.3%	-1.9%	10.9%	6.3%
<i>Imports (%)</i>	1.7%	3.7%	4.2%	6.7%
Inflation (end of period. YoY %)	8.8%	8.5%	10.0%	7.8%
Exchange Rate vs US dollar (end of period)	2.92	3.52	3.60	3.95
Exchange Rate vs US dollar (average)	2.72	3.02	3.59	3.79
Official Interest Rate (average)	8.4%	8.4%	11.5%	9.5%
Current Account Balance (% of GDP)	-3.7%	-3.8%	-4.5%	-4.8%
Central Government Budget Balance (% of GDP)	-1.0%	-1.1%	-2.0%	-2.0%
EU Defined Public Debt (% of GDP)	27.5%	28.3%	28.9%	30.6%

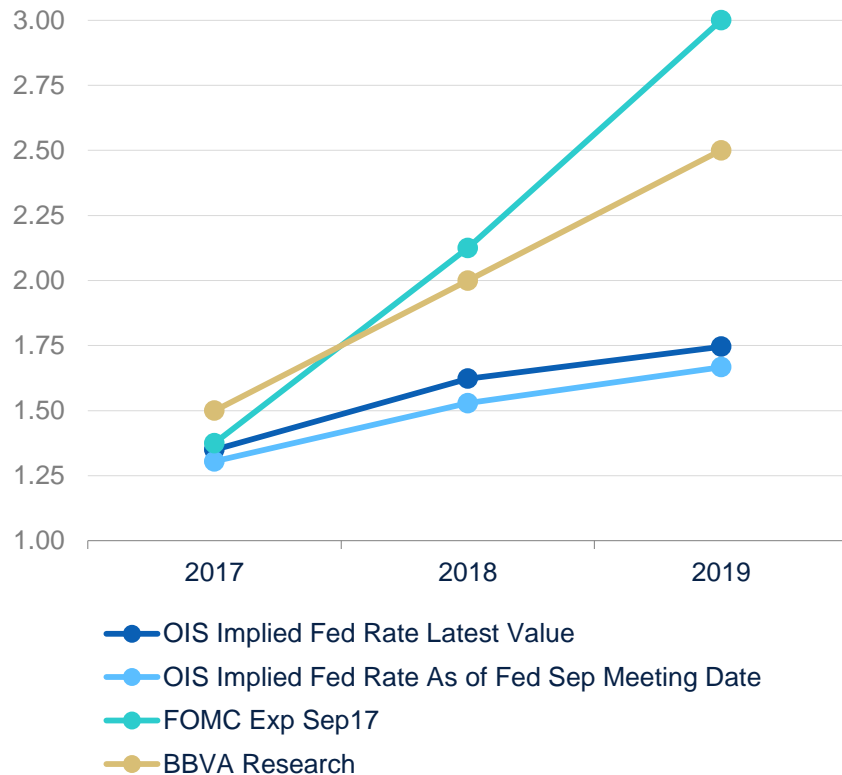
Turkey

The Balance of Risks

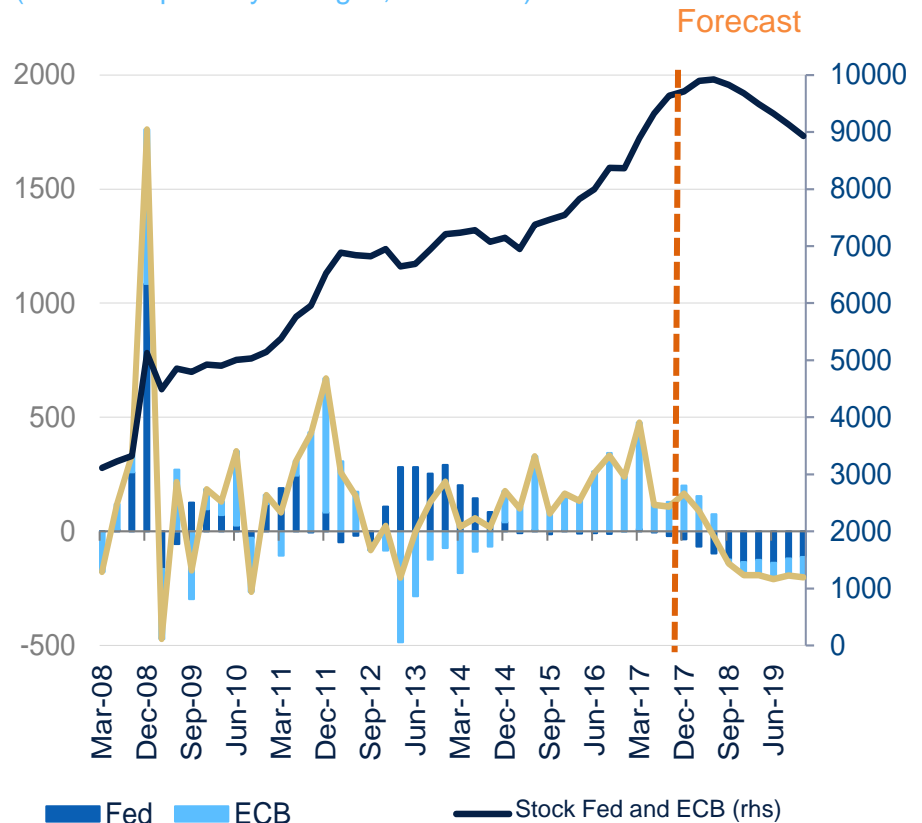


The major Central Banks’ “normalization” policies should be monitored as they can exert some pressure on EM assets

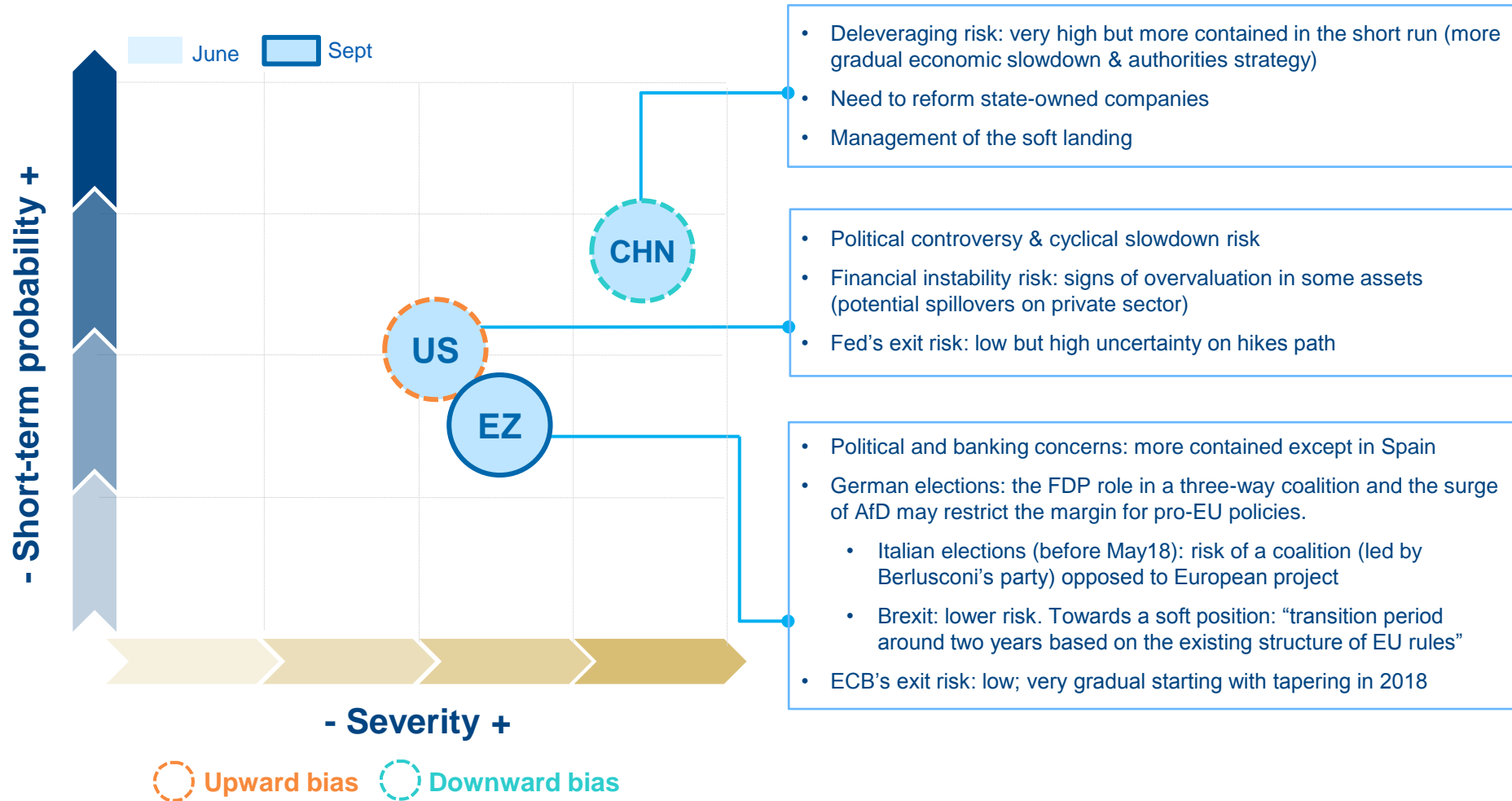
US: FOMC Interest Rate Expectations
(Level)



FED and ECB balance sheet
(level and quarterly changes, in USDbn)



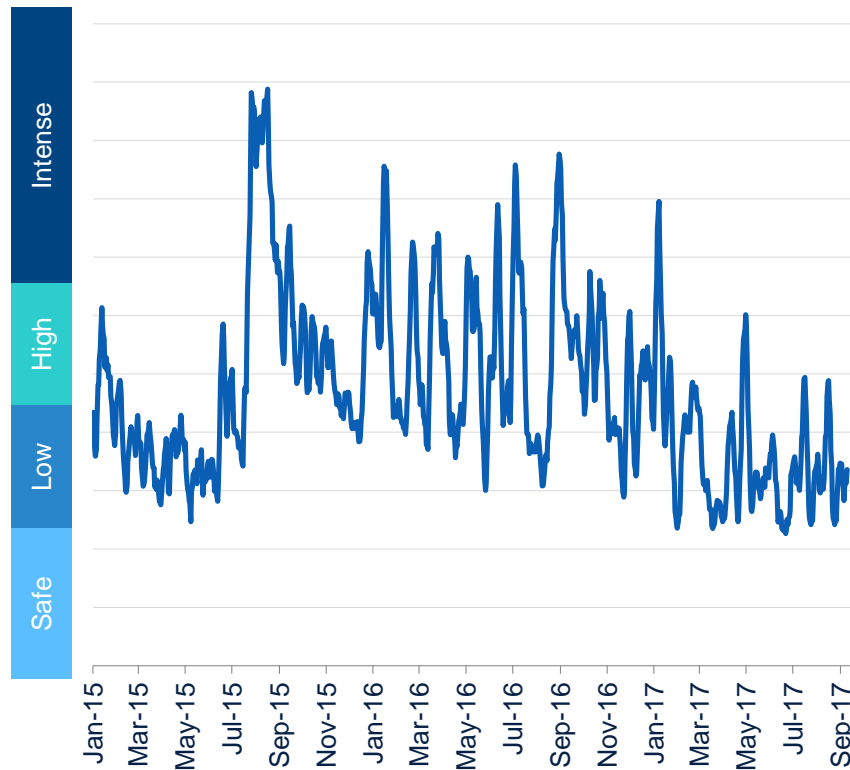
Short-term rebalancing from China to US could be a risk factor



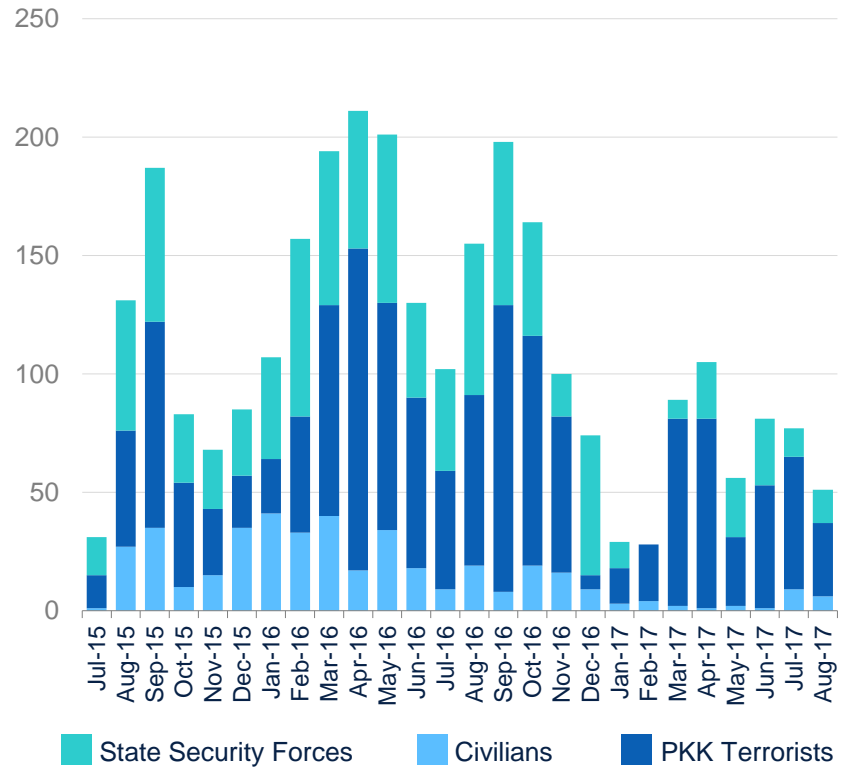
**Other risks: Geopolitical (North Korea); Protectionism (China-US)

The Security Climate in Turkey has improved within a year

Turkey: Conflict Index
(Conflict events / Total in Media)

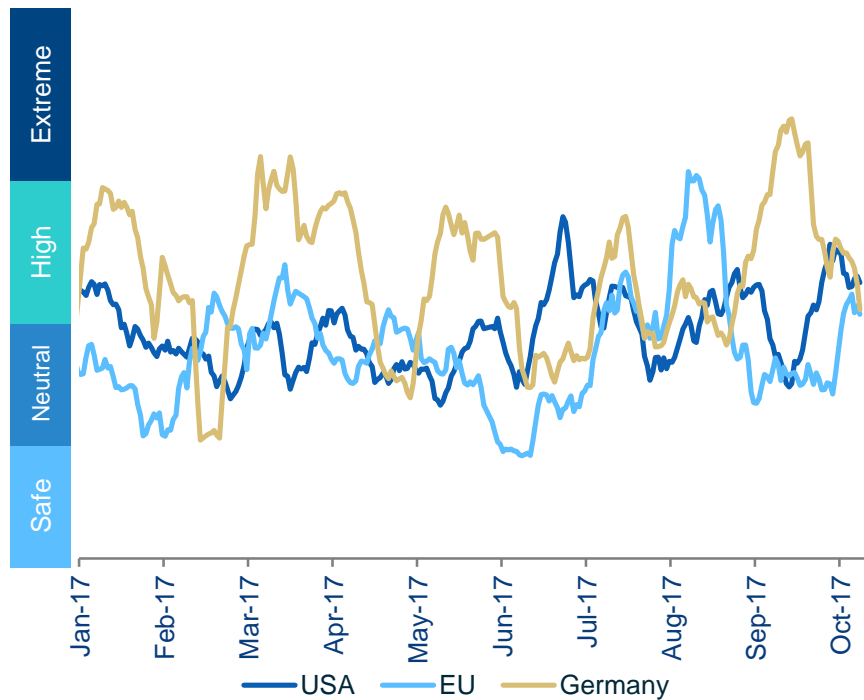


Death tolls in PKK terrorist attacks

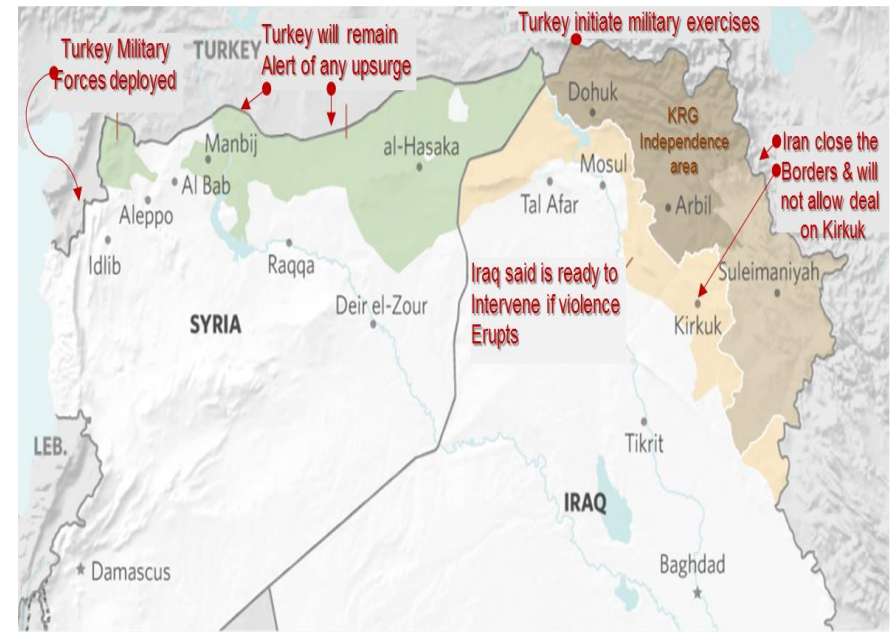


Get ready for a harsh statement on Turkey at the next EU summit... and watch the Kurdish-Iraqi developments

Turkey Foreign Affairs Index



Turkey: The Iraqi Kurdistan Referendum



This report has been produced by the Turkey, China and Geopolitics Unit

Chief Economist for Turkey, China and Geopolitics Unit

Álvaro Ortiz

alvaro.ortiz@bbva.com

Deniz Ergun

denizerg@garanti.com.tr
+90 212 318 10 59

Ali Batuhan Barlas

alibarl@garanti.com.tr
+90 212 318 10 67

Seda Güler

sedagul@garanti.com.tr
+90 212 318 10 64

Yiğit Engin

yigite@garanti.com.tr
+90 212 318 10 60

Asuman Kemiksiz

asumankem@garanti.com.tr
+90 212 318 10 58

With the collaboration of

Global Economic Situations

Miguel Jiménez

mjimenezg@bbva.com

BBVA-Research

Jorge Sicilia Serrano

Macroeconomic analysis

Rafael Doménech

r.domenech@bbva.com

Global Economic Situations

Miguel Jiménez

mjimenezg@bbva.com

Global Financial Markets

Sonsoles Castillo

s.castillo@bbva.com

Long-Term Global Modelling and Analysis

Julián Cubero

juan.cubero@bbva.com

Innovation and Processes

Oscar de las Peñas

oscar.delaspenas@bbva.com

Financial Systems and Regulation

Santiago Fernández de Lis

sfernandezdelis@bbva.com

International Coordination

Olga Cerqueira

Olga.cerqueira@bbva.com

Digital Regulation

Álvaro Martín

alvaro.martin@bbva.com

Regulation

María Abascal

maria.abascal@bbva.com

Financial Systems

Ana Rubio

arubiog@bbva.com

Financial Inclusion

David Tuesta

David.tuesta@bbva.com

Spain and Portugal

Miguel Cardoso

miguel.cardoso@bbva.com

United States

Nathaniel Karp

Nathaniel.karp@bbva.com

Mexico

Carlos Serrano

carlos.serranoh@bbva.com

Middle East, Asia and

Geopolitical

Álvaro Ortiz

alvaro.ortiz@bbva.com

Turkey

Álvaro Ortiz

alvaro.ortiz@bbva.com

Asia

Le Xia

Le.xia@bbva.com

South America

Juan Manuel Ruiz

juan.ruiz@bbva.com

Argentina

Gloria Sorensen

gsorensen@bbva.com

Chile

Jorge Selaive

jselaive@bbva.com

Colombia

Juana Téllez

juana.tellez@bbva.com

Peru

Hugo Perea

hperea@bbva.com

Venezuela

Julio Pineda

juliocesar.pineda@bbva.com

Turkey Economic Outlook Fourth Quarter

BBVA Research

October 2017

