Monthly Economic Monitor Turkey

BBVA Research

February 2018

Adem İleri
Ali Batuhan Barlas
Deniz Ergün
Seda Güler
Serkan Kocabaş
Yiğit Engin

Key messages

1. Global demand remains solid and well-synchronized, while uncertainties on the pace of global central banks' policy normalization trigger volatility in financial markets

2. Preliminary data signals only a smooth moderation in economic activity at the start of the year. We expect 7% GDP growth in 2017 to moderate towards 4.5% this year

3. The recovery in labor market is still supported by robust growth but losing some momentum

4. Base effects on inflation started to help as of January. Relatively stable levels of exchange rate against US dollar keep the risks balanced on our year-end inflation estimate of 9%

5. The Central Bank remains tight due to high inflation expectations. Fiscal policy stays accommodative on continuing high expenditures and recently announced incentives

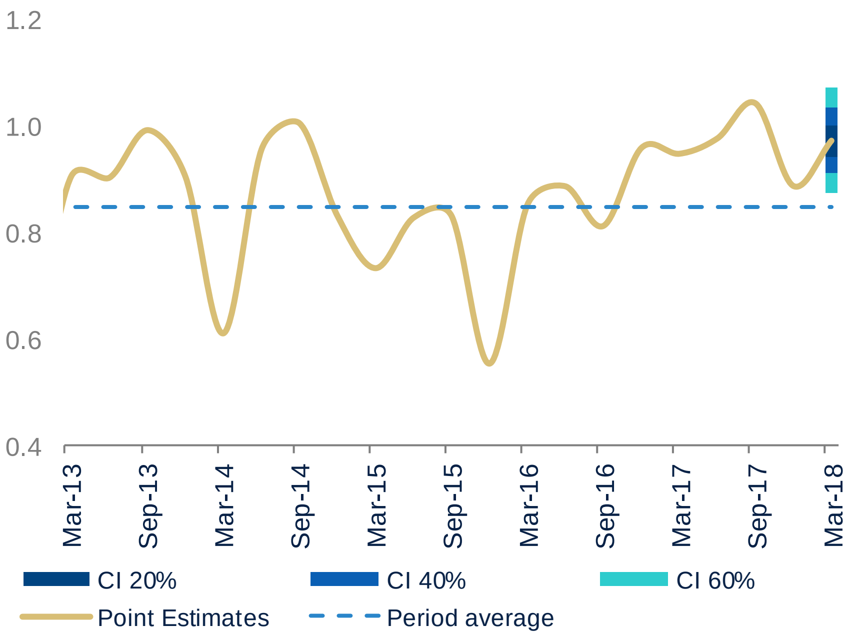
6. Strong activity and investment recovery (intensive in imports) pose risks on current account deficit, while expected normalization in gold imports might compensate the higher energy bill this year

GLOBAL

Supportive growth, increasing volatility in financial markets

1Q18 data so far suggest a slight uptick in global growth at rates observed over the last year (1% QoQ)

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



- Despite the stability of industrial production in December, 4Q data improved after the moderation observed in 3Q17
- Confidence is at very strong levels so far in 1Q, though it gives some signs of expected exhaustion (in the Eurozone)
- Global trade gained further momentum by the end of 2017, benefiting from the recovery in investment and the industrial sector, including in EM's
- BBVA-GAIN model estimates global GDP to grow at 1% QoQ in 1Q18, after 0.9% by end-2017

Source: BBVA Research & Bloomberg

BBVA Research

Last month key events in financial markets: diagnosis and prospects

KEY EVENTS

- Bond selloff, US yields 2.80%-3%, mainly driven by higher real rates and risk premium
- Spike in equity volatility, extreme event due to technical factors, gradually normalizing
- Selloff (overprized) equity, generalized correction, but almost reverted after the US fiscal deal
- Contained contagion to other markets, credit largely unaffected as well as EM
- Financial tensions have increased across the board, but still below historical average
- High yield and EM funds have started to register outflows

DIAGNOSIS AND PROSPECTS

- Economic fundamentals remain strong globally with inflationary pressures growing gradually
- Major central banks will proceed with monetary policy normalization
- Financial markets adapting to: higher volatility (above ultra low level) and tighter financial conditions (on shrinking global liquidity and higher global risk premia). The end of complacency and, probably, higher sensitivity to any shock
- To monitor closely in the short run: persistence and contagion to other markets, particularly credit and EM, the evolution of financial tensions (it has the potential to affect growth), the Fed (faster tightening) and US bond yields (fiscal impact)

Source: BBVA Research

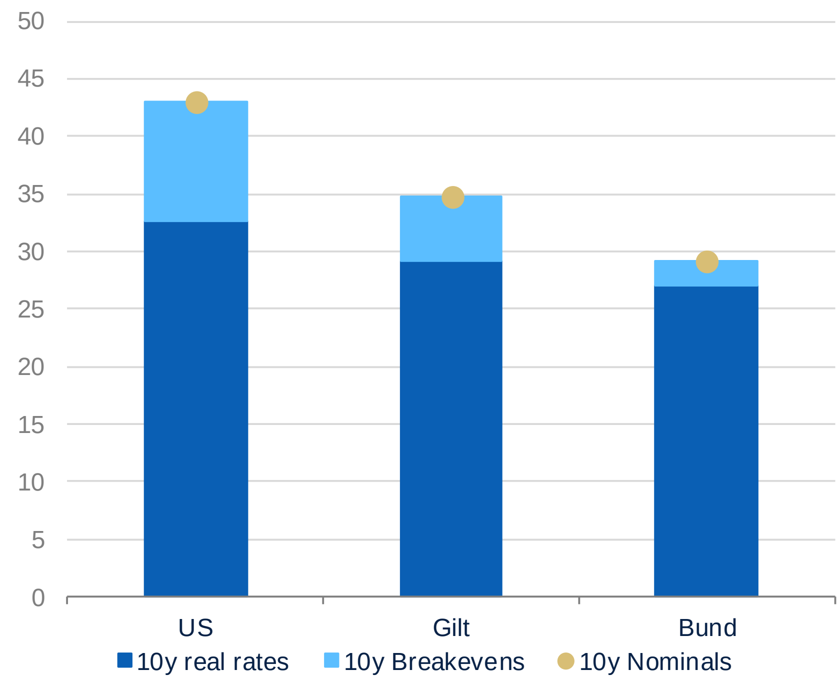
BBVA Research

Bond yields have risen globally led by real yields. The sell-off was driven by UST

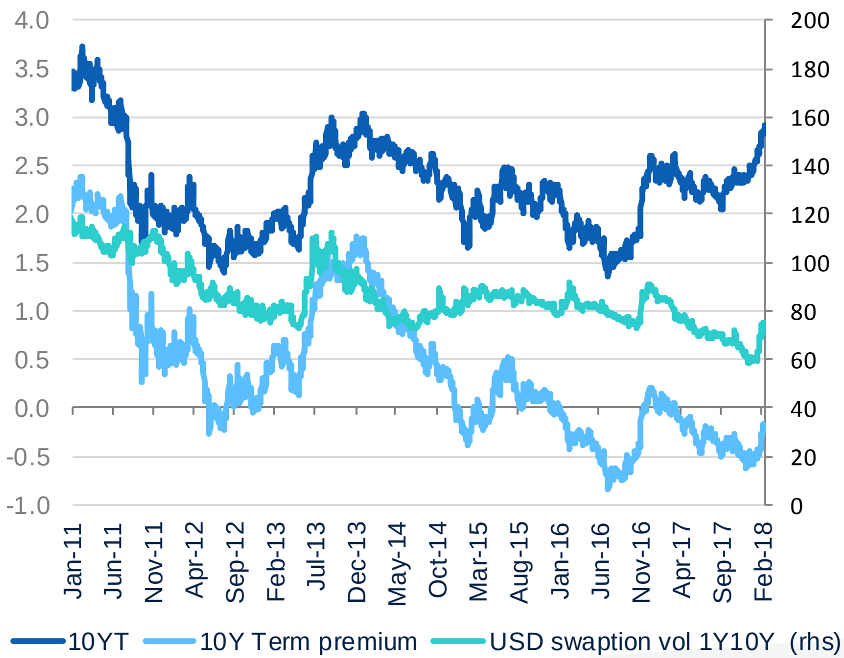
- Although inflation expectations have been rising since 2016, the recent increase in nominal yields in the U.S. has been mostly driven by increases in real rates.
- The movement in the UST was also driven by higher term premium (highly correlated with swap volatility): uncertainty about inflation and Fed tightening

10Y UST, Bund and Gilt, YTD changes

(bps)



UST 10y, term premium and Swaption volatility

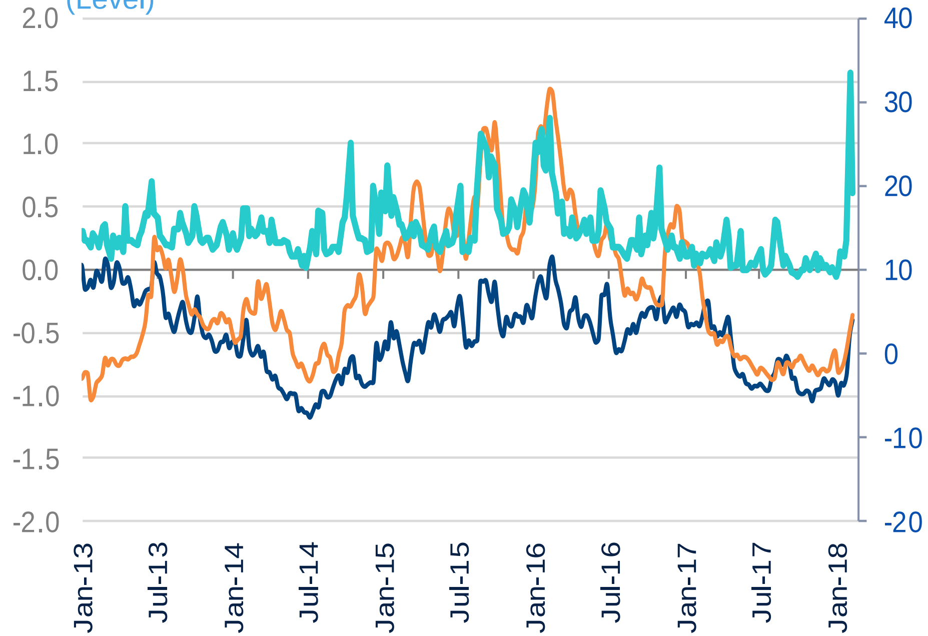


Source: BBVA Research

A spike in equity volatility by technical factors, though spillovers to other risky assets were contained

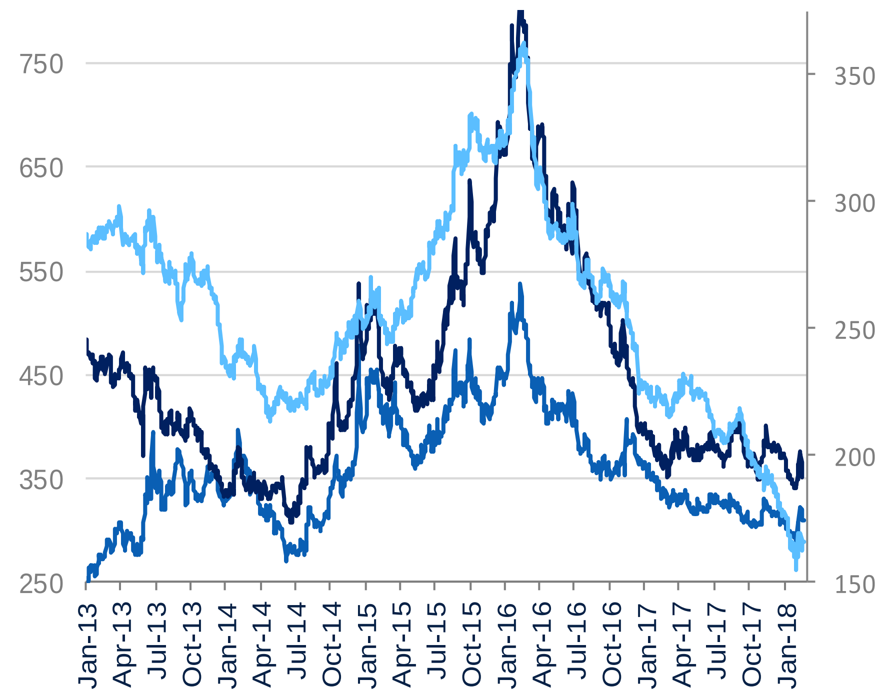
BBVA Financial Tension Index and VIX

(Level)



Credit spread: BAA, US HY and EMBI

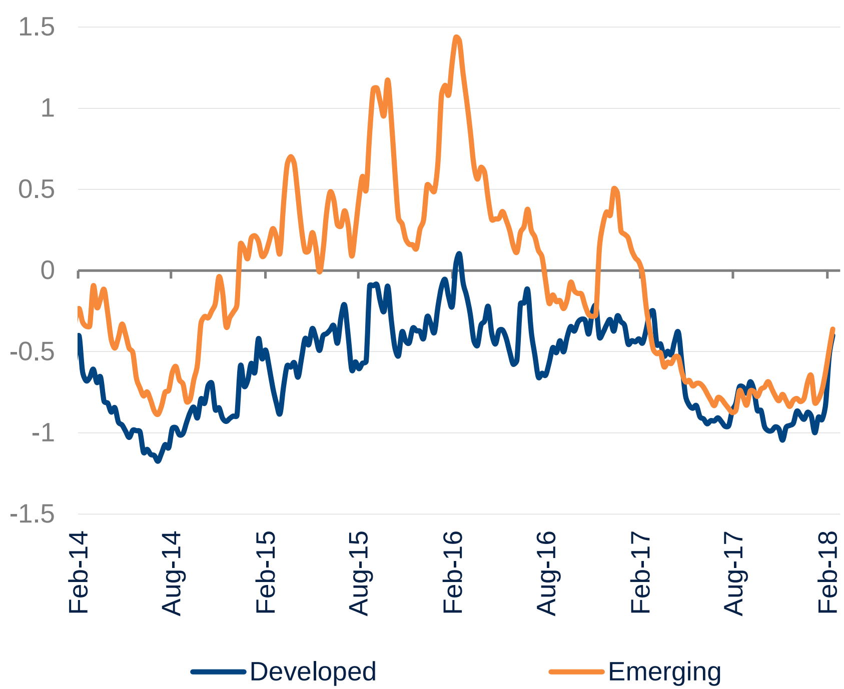
(bps)



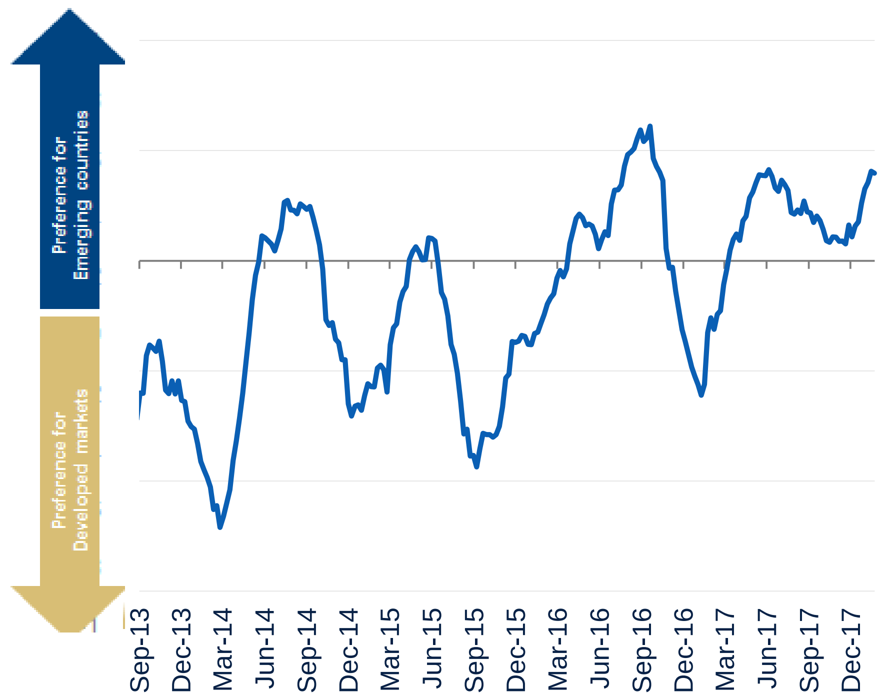
Source: BBVA Research, Bloomberg

New episode of higher volatility: rising sovereign yields with a weak US dollar but still preference for EM assets

BBVA Research Financial Stress Index
(normalized index)



BBVA Research Financial Stress Index Regional Map



This recent episode of volatility is expected to be short-lived (it was not driven by a deterioration of economic fundamentals) but it is not expected to return to previous levels (around 10). EM and high-yield will be key points to monitor onwards.

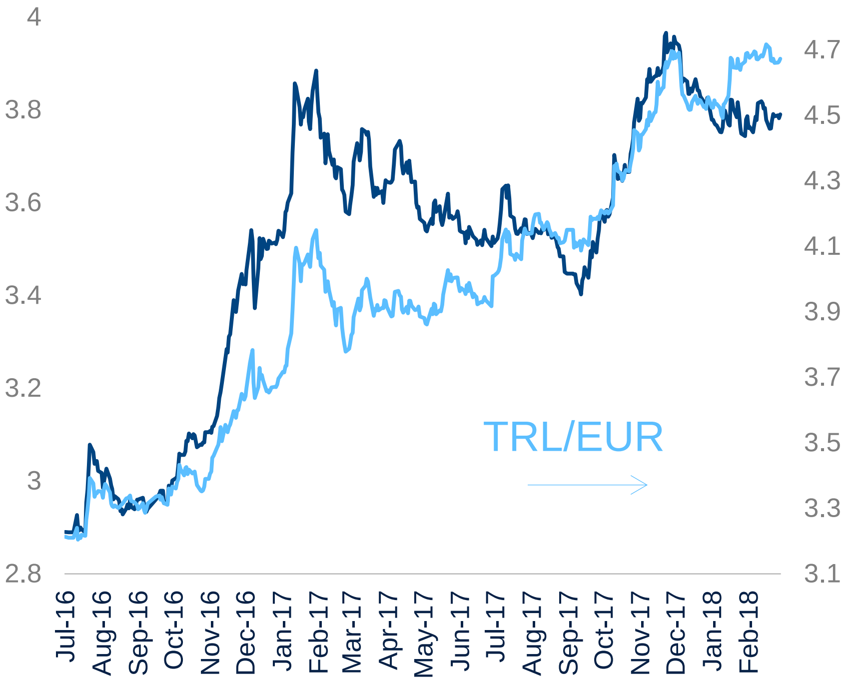
BBVA | Research

Turkish Economy

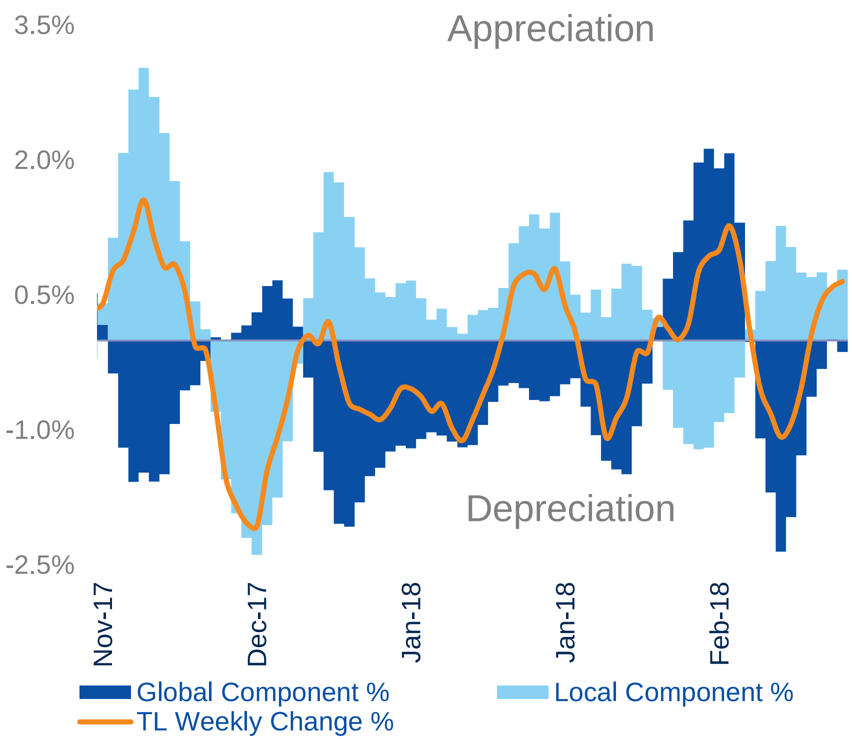
High growth & High Inflation

Local factors play on the depreciation side for TL against US dollar on geopolitical tensions, while deteriorating global factors on lower risk appetite also start to push

Turkish Lira vs US Dollar & Euro
(Level)



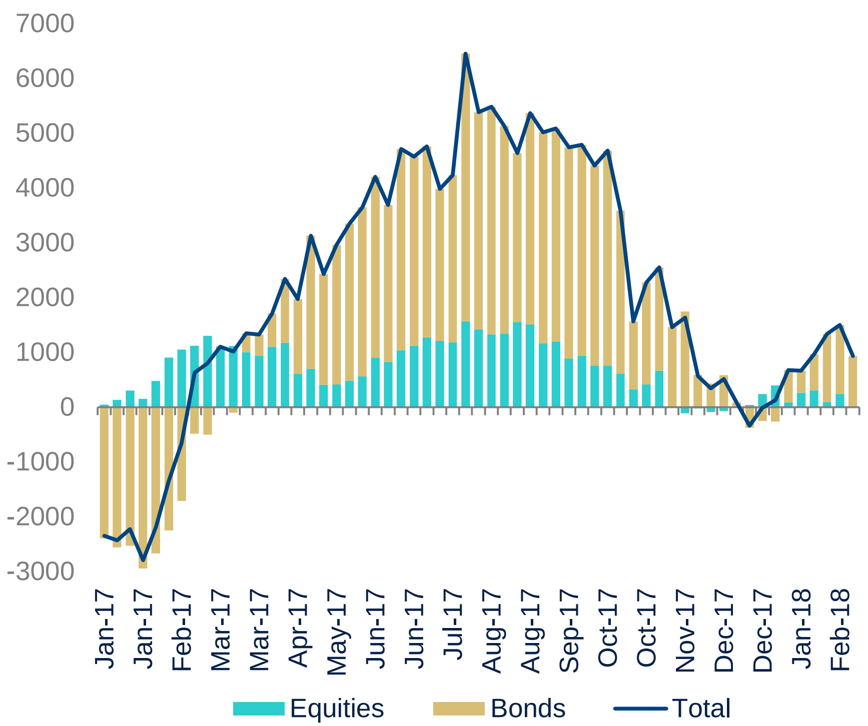
Turkish Lira: Global and Local Factors
(weekly change)



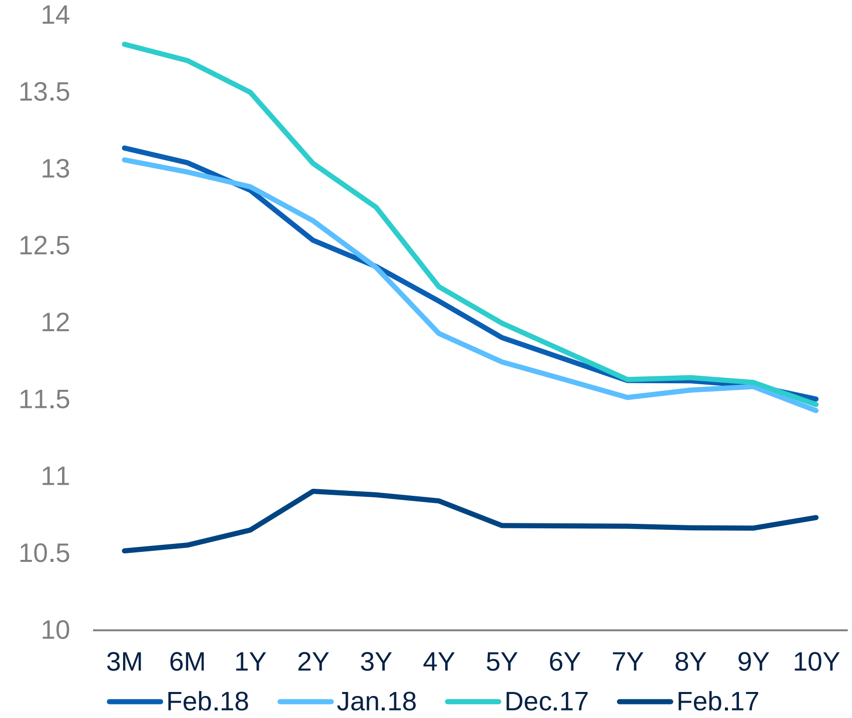
Source: CBRT, Bloomberg and BBVA Research

Flows to Turkish financial assets have also weakened, resulting in a upward shifted yield curve in both ends due to both higher risk premiums and elevated inflation expectations

Flows to Turkish Assets
Level, mn$, 13-week moving sum



Yield Curve
(%)



Source: Garanti Research, CBRT, Bloomberg

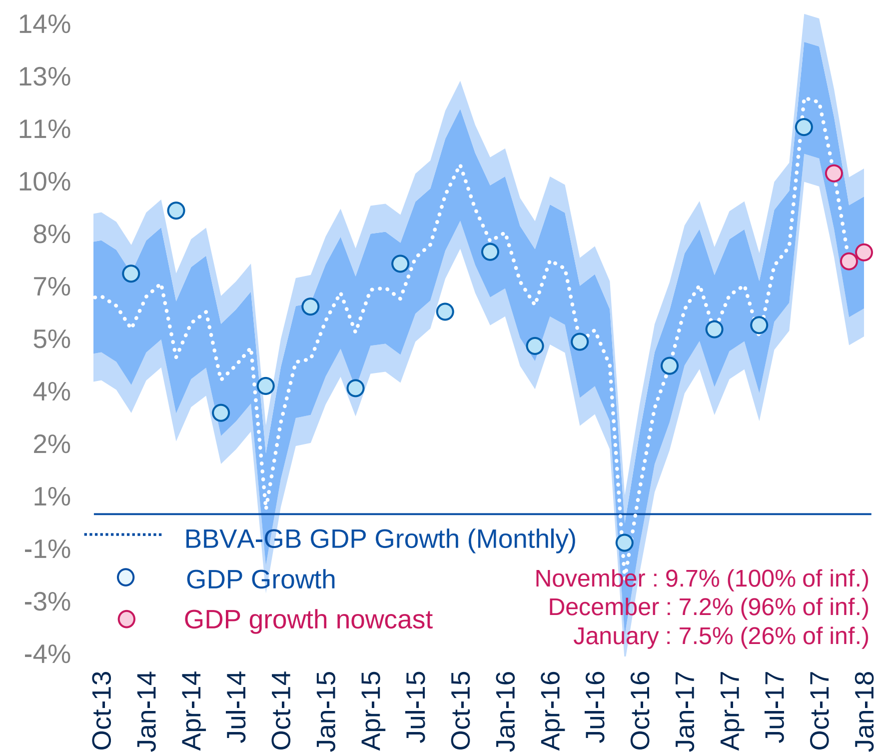
Economic Activity: GDP continues to remain solid but faces some moderation

Activity Indicators
(3 MA, YoY Change, %)

		2017							2018
	Mean	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Industrial Production	3.9	2.3	7.8	7.8	13.9	8.7	9.7	7.5	
Non-metal Mineral	-0.7	0.8	8.1	8.4	14.2	7.7	8.7	10.9	
Electricity Production	3.2	4.5	8.4	8.5	12.2	9.5	9.7	6.5	4.0
Auto Sales	0.7	-9.7	2.4	7.1	14.6	6.2	-2.2	-16.2	
Tourist Arrivals	6.2	26.5	36.5	45.5	45.3	38.2	310	24.4	
Number of Employed	314	2.7	3.5	4.4	4.6	4.8	5.0		
Number of Unemployed	2.4	10.5	6.1	15	-0.8	-5.2	-8.2		
Auto Imports	65.2	-14.4	-6.7	-3.4	3.1	-0.8	-8.4	-18.0	
Auto Exports	10.1	24.0	23.2	9.8	6.4	18	2.9	0.5	
Financial Conditions	75.7	35.6	40.5	35.4	38.9	38.7	38.0	37.6	414
Commercial Int. Rate	13.8	16.3	17.0	16.2	16.6	16.5	16.5	17.1	17.9
Retail Sales	3.6	0.8	18	2.0	15	13	19	4.0	
Real Sector Confidence	106.1	108.8	107.7	110.2	111.2	112.2	109.8	109.2	110.9
MICA Forecast							9.7%	7.2%	7.5%
GDP YoY		5.4%			11.1%				

Contraction	Slow-down	Growth	Boom

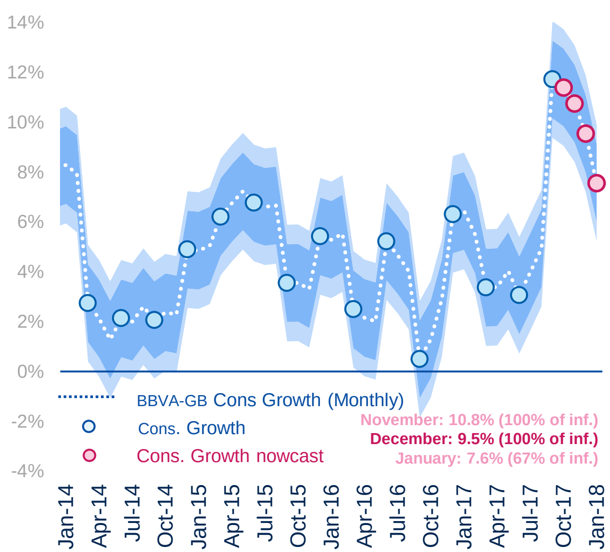
Monthly GDP Estimate and Realization
(YoY Change, %)



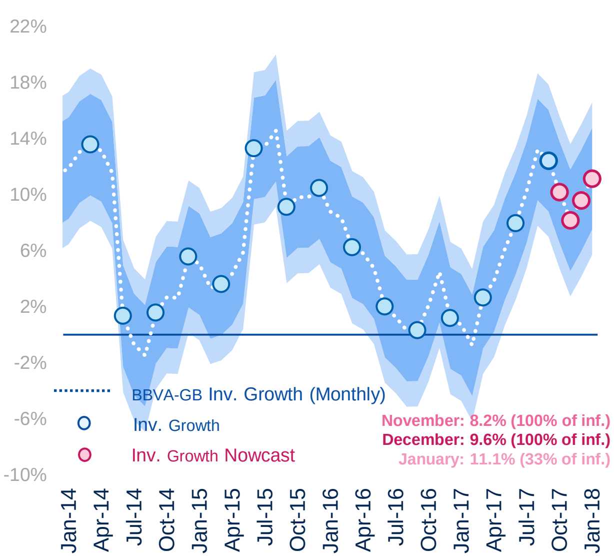
Source: Garanti Research, Turkstat, Bloomberg

Consumption and investment still remain high, while “net exports” is now dragging growth.

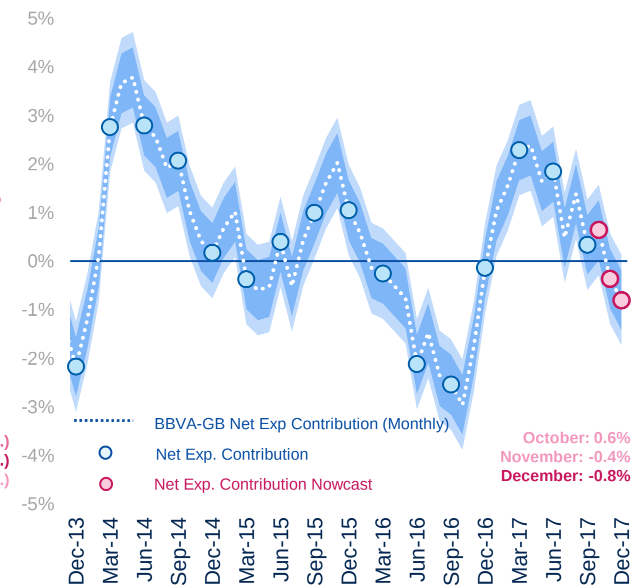
Monthly Consumption Nowcast
(YoY Change, % 3M MA)



Monthly Investment Nowcast
(YoY Change, % 3M MA)



Monthly Net Exports Nowcast
(% contribution to GDP growth, 3M MA)

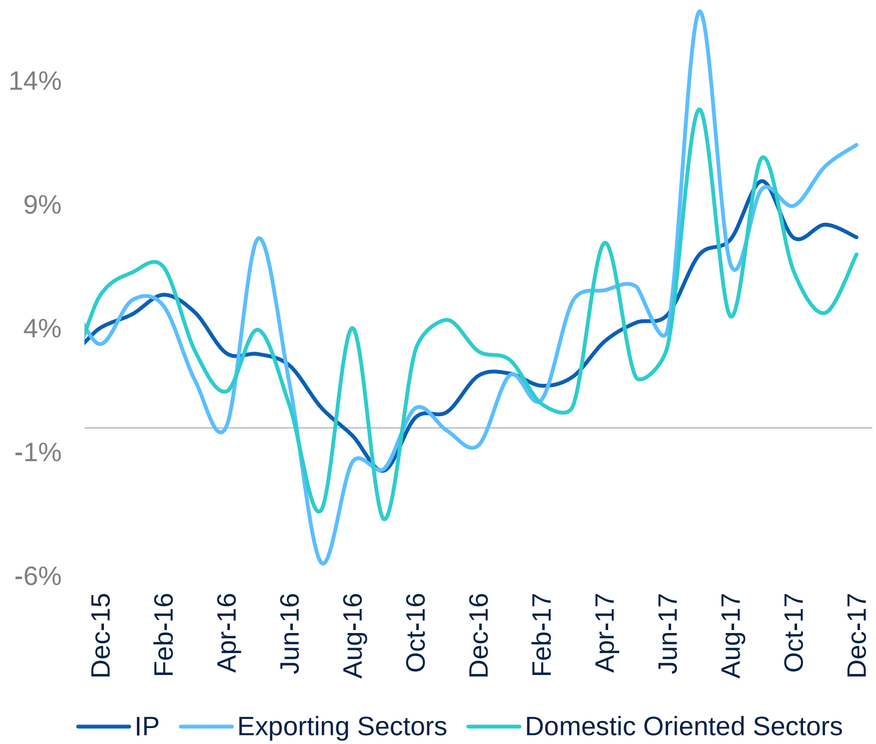


Source: BBVA Research

Moderation in industrial production stemmed from domestic demand oriented sectors, while exporting sectors kept its growth momentum on weak exchange rate and strong activity in the global economy

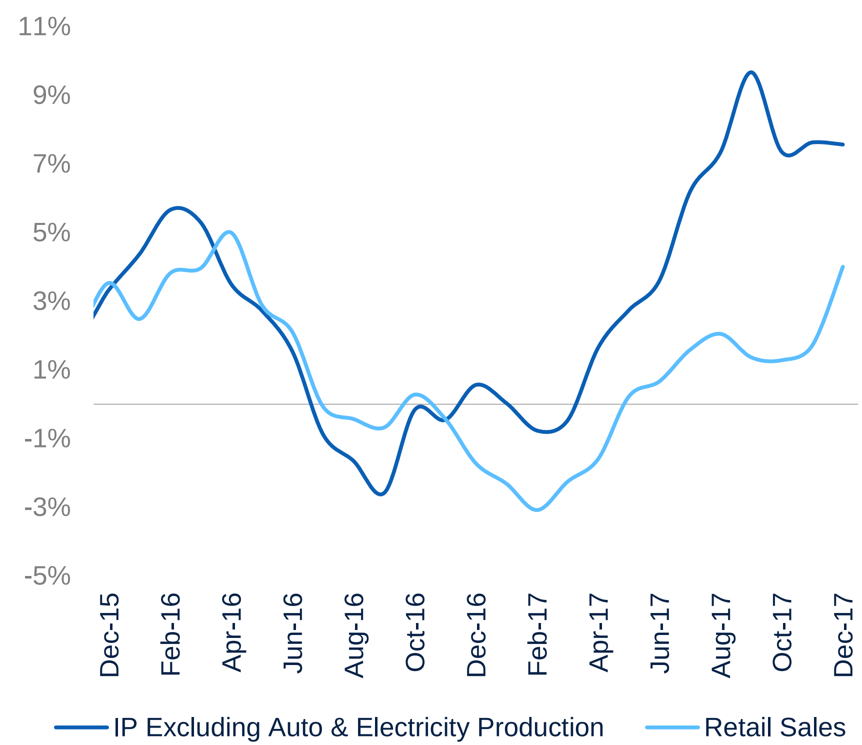
Sectors in Industrial Production (IP)

(3MA, calendar adj, YoY)



Retail Sales and IP exc. Auto and Electricity

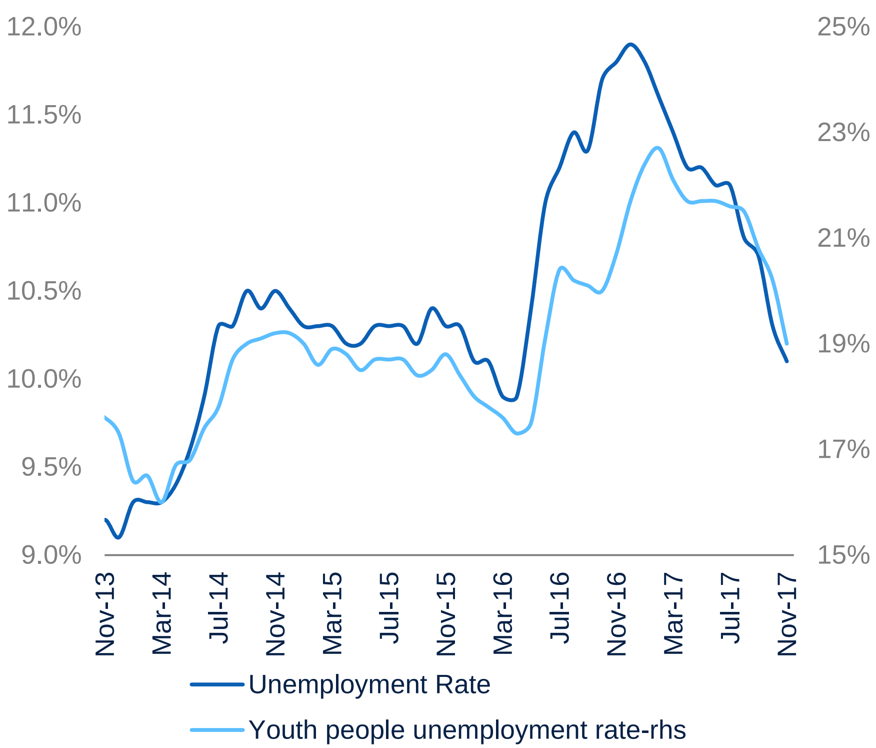
3MA, calendar adj, YoY



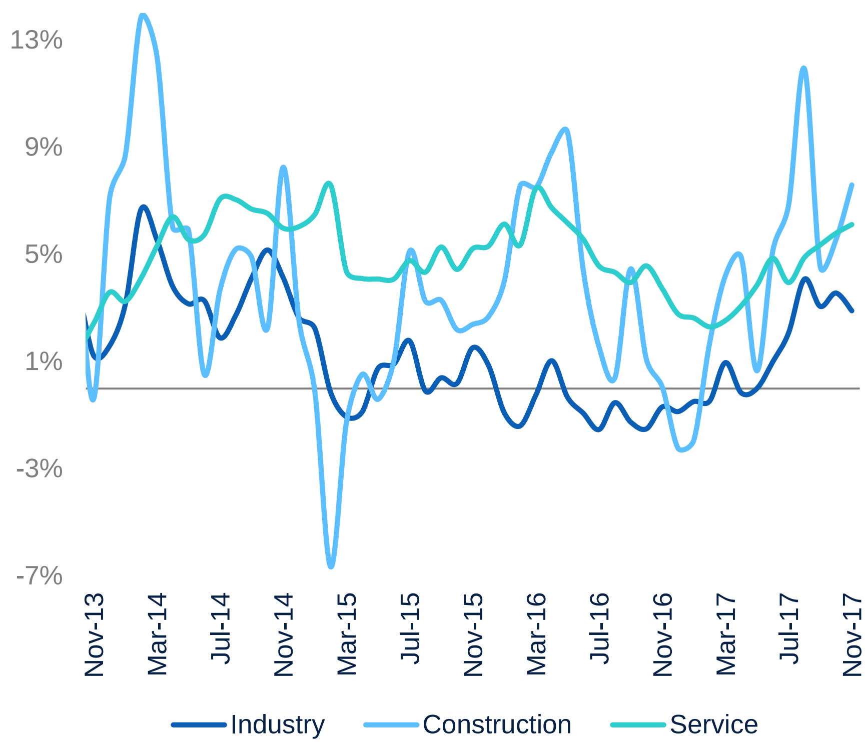
Source: Garanti Research, Turkstat, CBRT

Solid activity continued to support the labor market in 4Q

Unemployment Rate
(SA, %)



Employment Growth in Sectors
(%YoY)

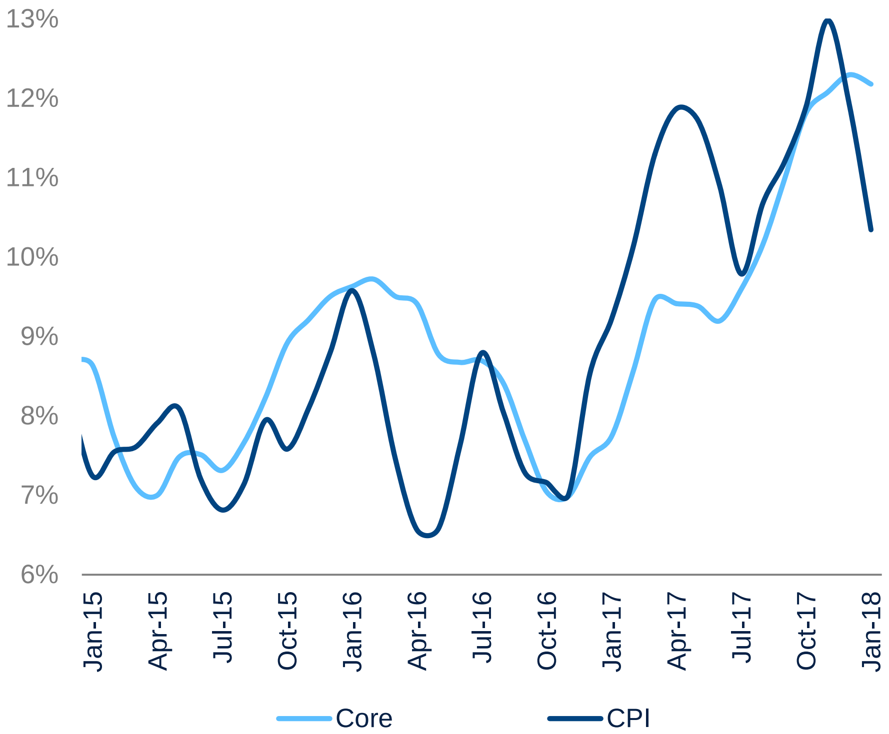


Source: Turkstat and BBVA Research

Base effects on inflation started to help in January. Core inflation stays rigid on inertia, robust domestic demand and lagged effects of exchange rate depreciation

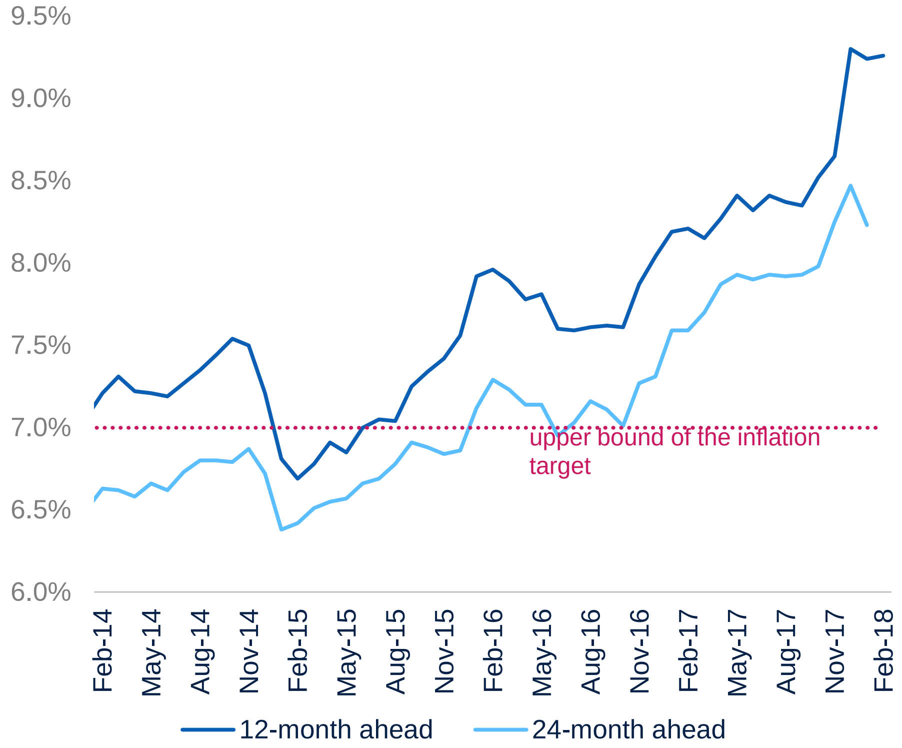
CPI and Core Inflation (CBRT C Index)

YoY



CBRT Survey: Inflation Expectations

YoY

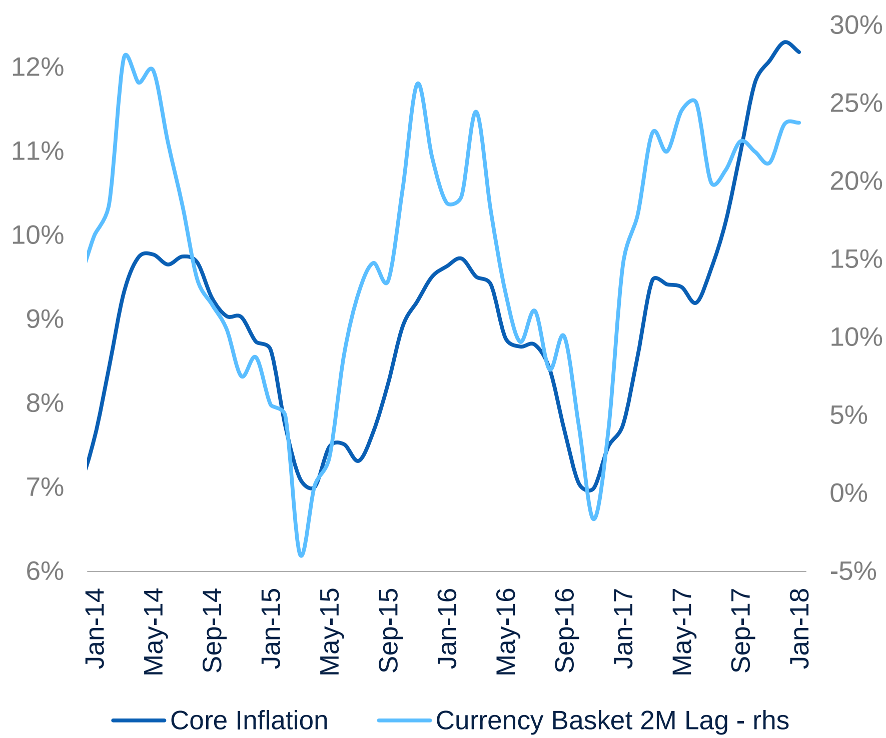


Source: Garanti Research, Turkstat, CBRT

Exchange rate pass-through and cost-push factors from still high levels of producer prices inflation keep pressures on inflation

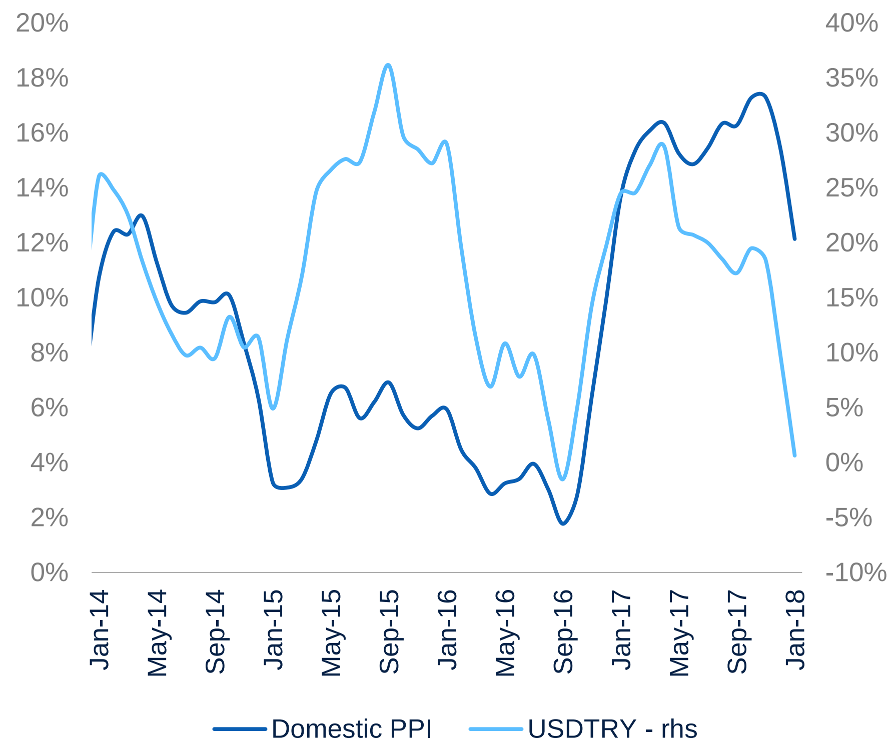
Core Inflation and Currency Basket

YoY



Domestic PPI and USD/TL

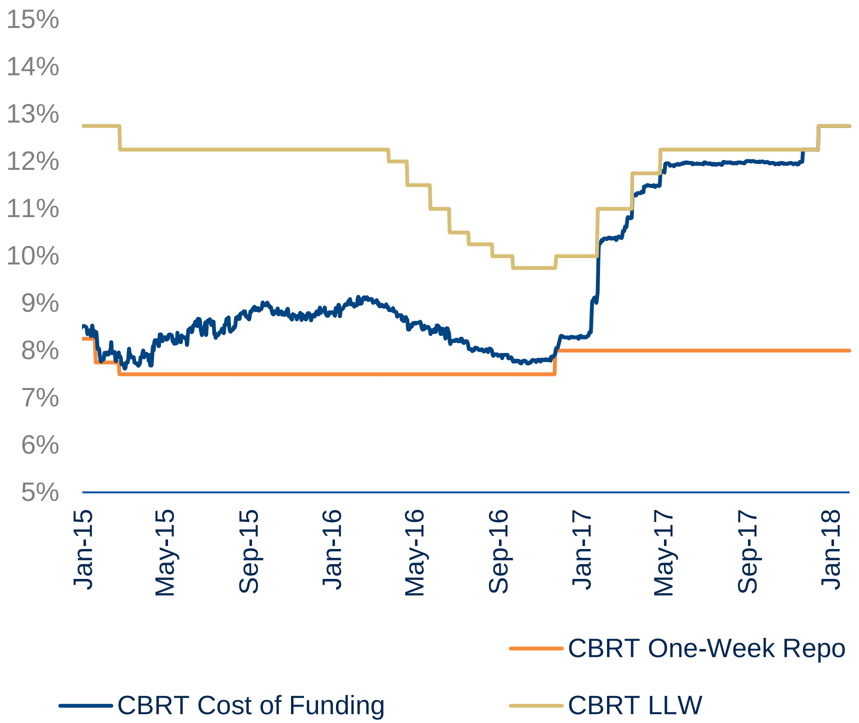
YoY



Source: Garanti Research, Turkstat, CBRT

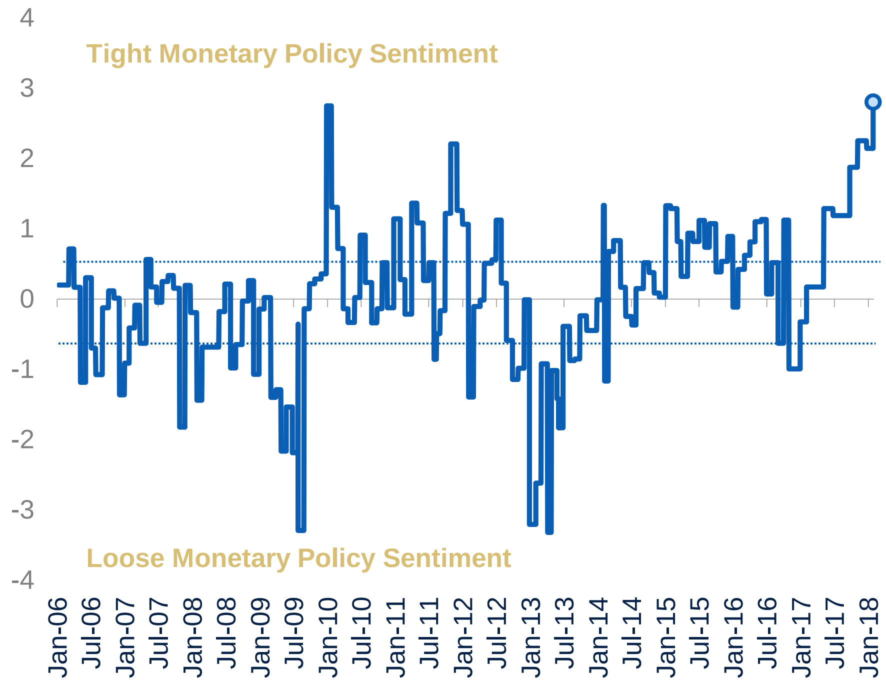
The CBRT maintains the “tight” policy stance, supported by verbal statements

CBRT Interest Rates
(Annual Level, %)



Source: CBRT

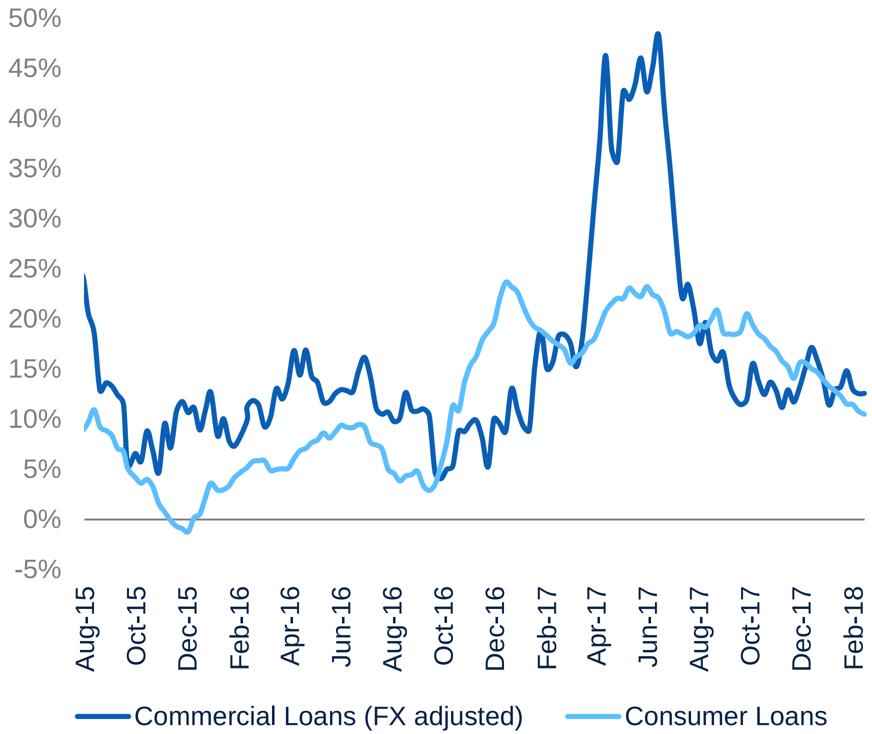
CBRT Monetary Policy Statement Sentiment
(Standardized, estimated through Big Data LDA Techniques from Minutes & Statements)



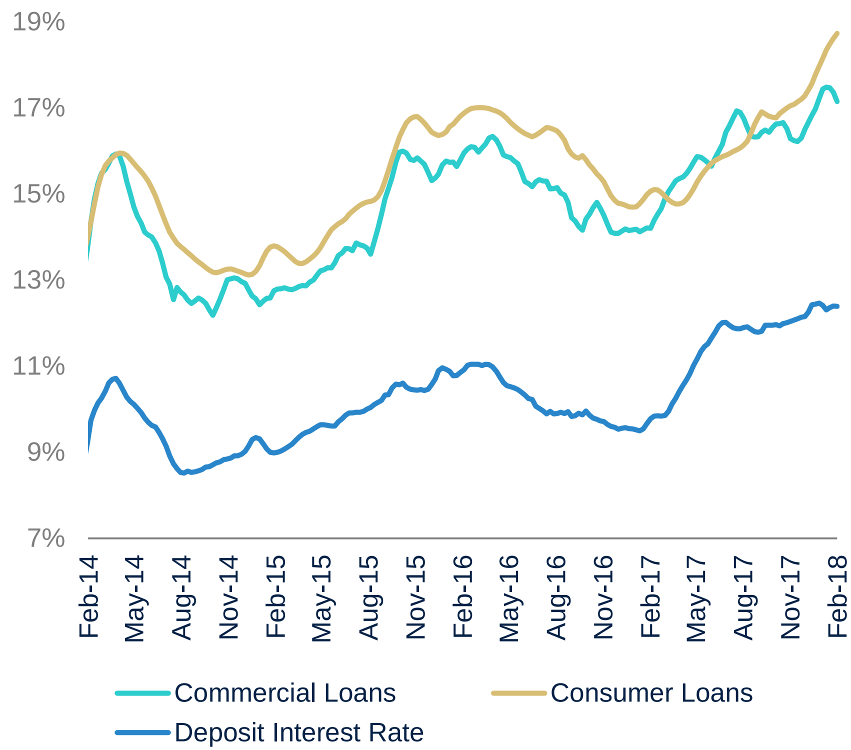
Source: BBVA Research

Loan growth rates continue to normalize, while interest rates remain high

Loan Growth Rates
13-week annualized



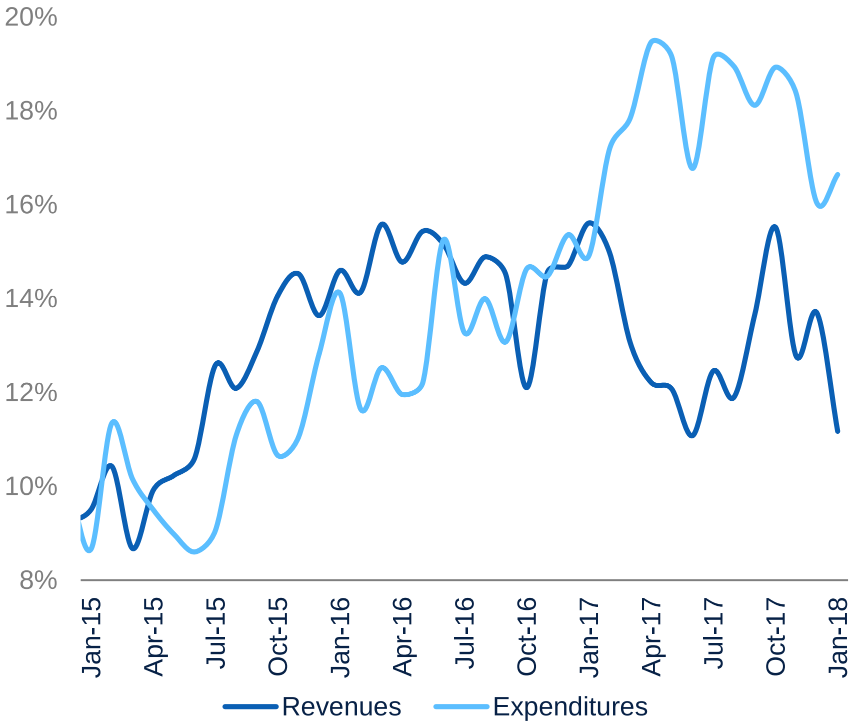
Loan Interest Rates
4-week average



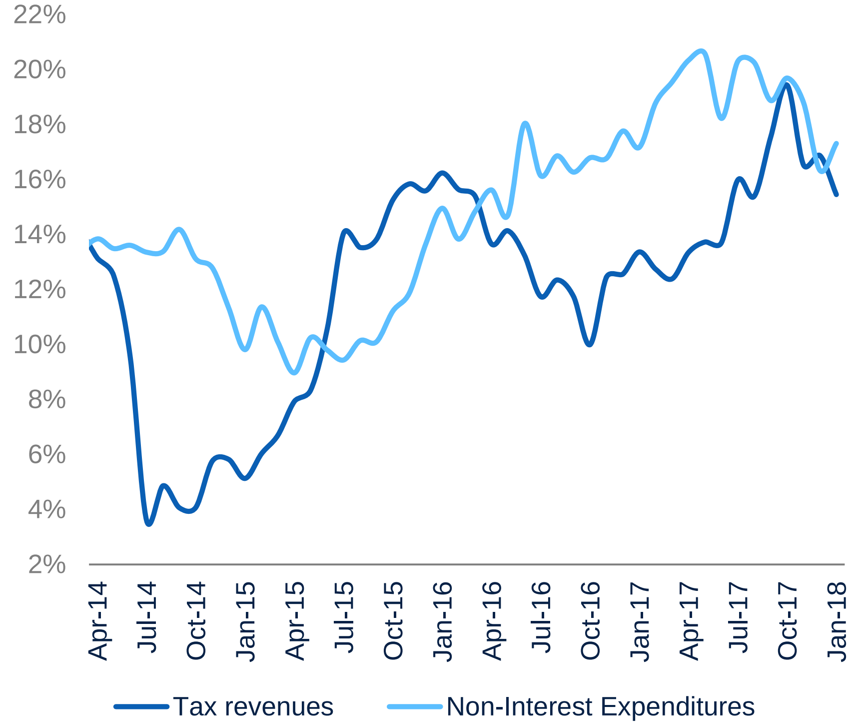
Source: Garanti Research, Turkstat, CBT, BRSA, Bloomberg

Central Government budget performance worsens in January as a result of strong expenditures growth, weak tax revenues and absence of privatization revenues

Budget Revenues and Expenditures
12-month sum, YoY Change



Tax Revenues and Non-Interest Expenditures
12-month sum, YoY Change



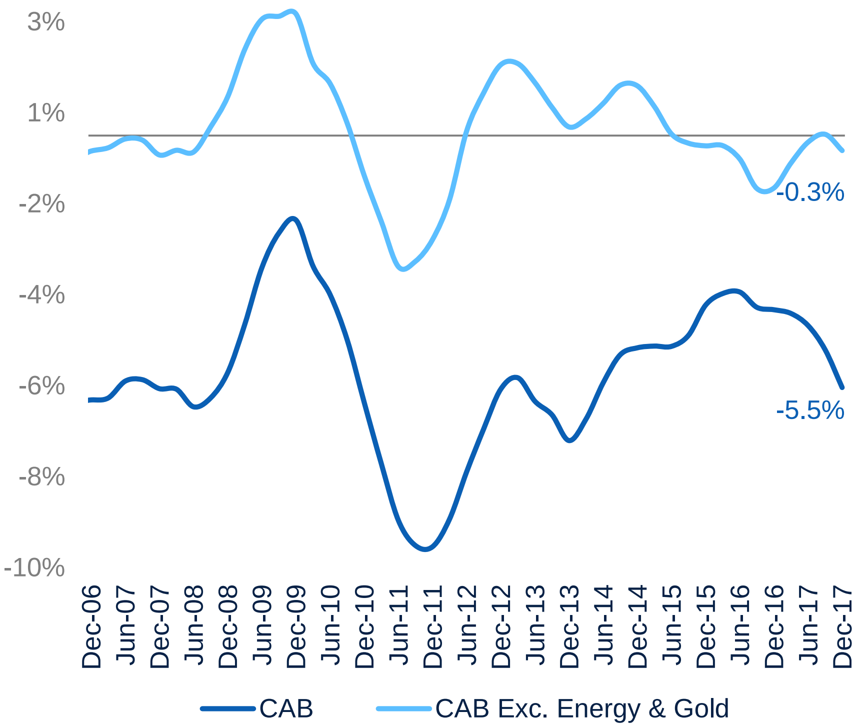
Source: Garanti Research, Turkstat, CBT, BRSA, Bloomberg

BBVA Research

Expected normalization in gold imports might compensate the higher energy bill. However, investment recovery (intensive in imports) could pose risks on CA deficit in 2018

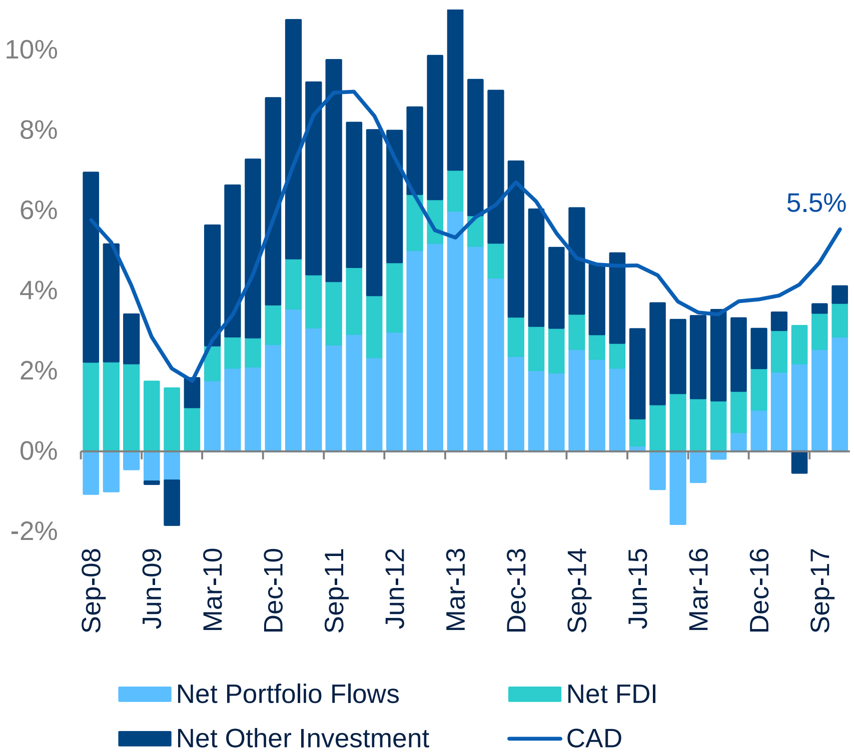
Current Account Balance

12M sum, % GDP



Current Account Financing

12M sum, % GDP

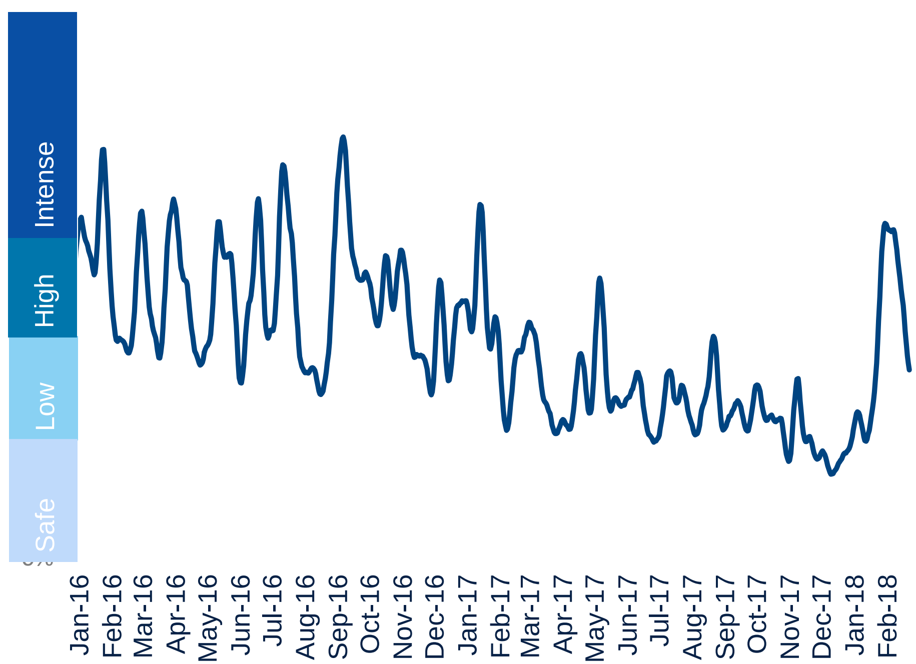


Source: CBRT, Turkstat and BBVA Research

The security climate has improved markedly allowing tourism arrivals and revenues to recover

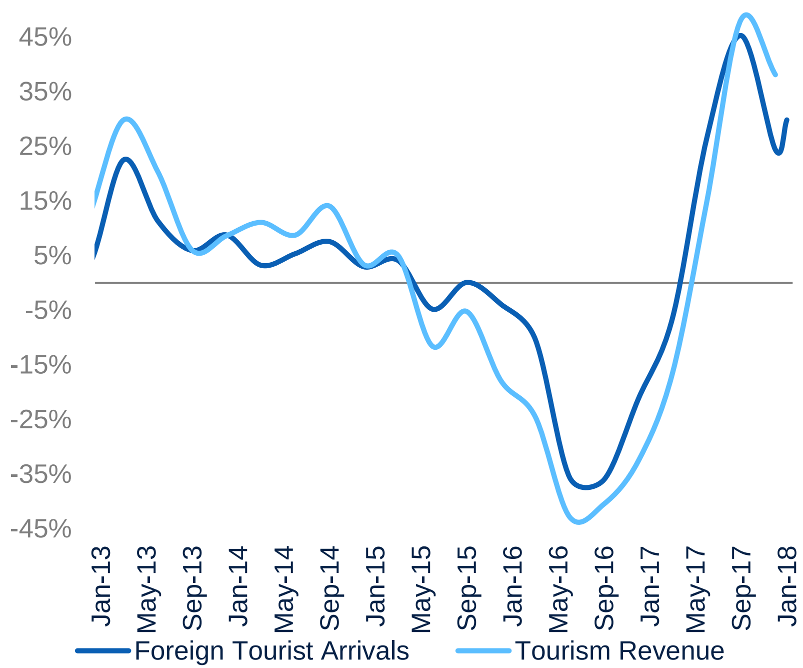
Turkey: Conflict Index

(Conflict News op Total News in News Media)



Number of Tourists and Tourism Revenues

(3MA, YoY)



Source: BBVA Research,, GDELT, Turkstat

Baseline forecasts

	2016	2017e	2018f	2019f	2020f	2021f	2022f	2023f
GDP (%)	3.2%	7.0%	4.5%	4.3%	4.5%	4.5%	4.5%	4.5%
Private consumption(%)	3.7%	6.2%	4.0%	3.6%	4.3%	4.1%	4.1%	4.3%
Public consumption (%)	*9.5%*	2.2%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Gross fixed investment (%)	2.2%	7.9%	3.0%	4.6%	5.1%	5.7%	5.6%	5.5%
Exports (%)	*-1.9%*	11.8%	8.4%	6.5%	6.0%	5.6%	5.6%	5.5%
Imports (%)	3.7%	6.1%	5.2%	5.6%	6.5%	6.5%	6.5%	6.5%
Inflation (end of period. YoY %)	8.5%	11.9%*	9.0%	8.0%	7.5%	7.0%	6.7%	6.0%
Exchange Rate vs US dollar (end of period)	3.52	3.77*	4.15	4.45	4.65	4.84	5.04	5.25
Exchange Rate vs US dollar (average)	3.02	3.65*	4.01	4.31	4.56	4.75	4.95	5.16
Official Interest Rate (end of period)	8.3%	12.8%*	12.8%	10.0%	8.3%	7.5%	7.5%	7.5%
Official Interest Rate (average)	8.4%	11.5%*	12.8%	11.6%	8.6%	7.8%	7.5%	7.5%
Current Account Balance (% of GDP)	-3.8%	-5.5%	-5.6%	-5.6%	-5.4%	-5.4%	-5.4%	-5.5%
Central Government Budget Balance (% of GDP)	-1.1%	-1.5%	-2.2%	-2.2%	-2.1%	-1.8%	-1.6%	-1.4%
EU Defined Public Debt (% of GDP)	28.3%	29.3%	30.9%	31.6%	31.7%	31.4%	31.1%	31.0%

F= forecast, * realization

BBVA | Research

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

Chief Economist for Turkey, China and Big Data Unit
Álvaro Ortiz
alvaro.ortiz@bbva.com

Adem İleri
ademil@garanti.com.tr
+90 212 318 10 63

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

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

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

Serkan Kocabaş
serkankoc@garanti.com.tr
+90 212 318 10 57

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

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

FOR ANY QUERIES PLEASE APPLY TO: BBVA Research: Calle Azul, 4. Edificio de la Vela - 4ª y 5ª plantas. 28050 Madrid, Spain. Tel.+34 91 374 60 00 and +34 91 537 70 00 / Fax+34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com

DISCLAIMER

BBVA | Research

Monthly Economic Monitor Turkey

BBVA Research

February 2018

Adem İleri
Ali Batuhan Barlas
Deniz Ergün
Seda Güler
Serkan Kocabaş
Yiğit Engin