

The logo for BBVA Research, featuring the text "BBVA" in a bold, white, sans-serif font, followed by "Research" in a smaller, lighter weight sans-serif font. A small teal square is positioned to the right of the word "Research".

BBVA Research

Turkey Economic Outlook 1Q19

February 2019

Creating Opportunities

Key messages

- The global expansion moderates further, with more evidence on protectionism, along with fears of higher tariffs in coming months. Global central banks show higher prudence/patience, which helps EMs to remain relatively resilient so far
- Maintenance of orthodox policies help the Turkish financial assets to stabilize and the rebalancing to accelerate. Internal (credit gap) and external (current account deficit) imbalances vanished, inflation is lagging behind
- The adjustment in economic activity gained momentum in 4Q18 but high frequency indicators show early signals of bottoming at the end of 2018. We expect GDP growth to be 3% in 2018 and decelerate further to 1% in 2019
- Inflation will likely stay high until the second half of the year, when easing pass-thru, negative output gap and supporting base effects will bring the year-end inflation to 16%
- We maintain our view that policy orthodoxy will remain alive. The Central Bank will wait until June 2019 to start a gradual easing cycle. Fiscal targets for 2019 are more challenging.
- Further decline in current account deficit will lower the external financial needs for 2019, which will also help the currency

Contents

- 01** Global Environment: moving towards a soft-landing of global growth, amid high uncertainty
- 02** Turkey: stabilization in financial markets. Real economic adjustment gains momentum
- 03** Turkey: Baseline Scenario



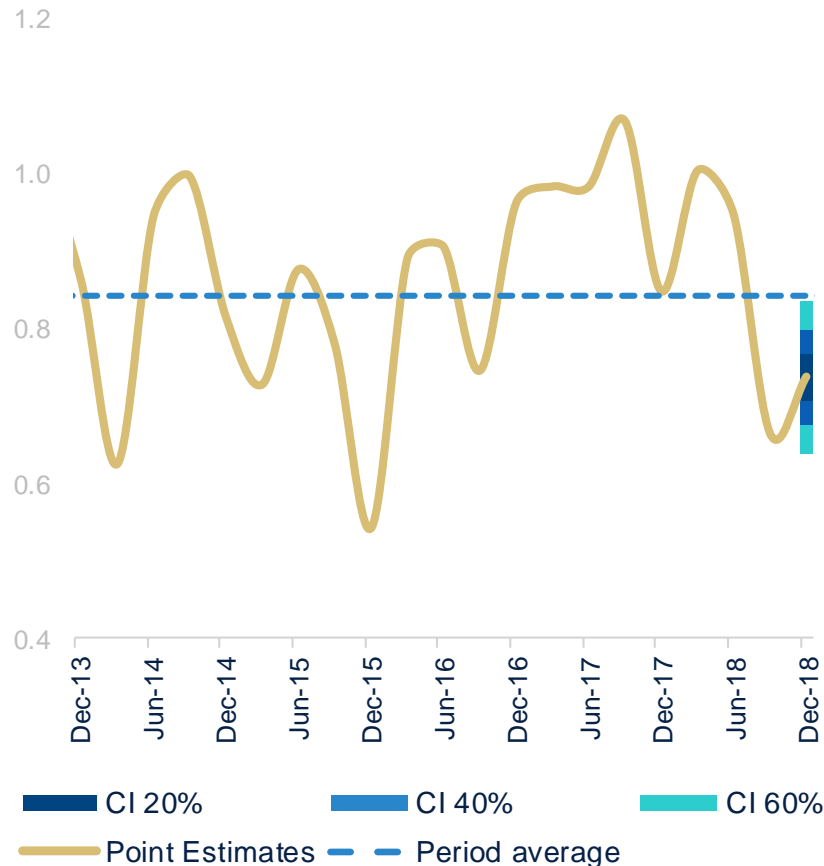
01

**Global environment:
moving towards a soft-landing
of global growth, amid high uncertainty**

Global GDP will likely recover somewhat in 4Q18, but the trend is clearly downwards

World GDP growth

(Forecast based on BBVA-GAIN, % QoQ)

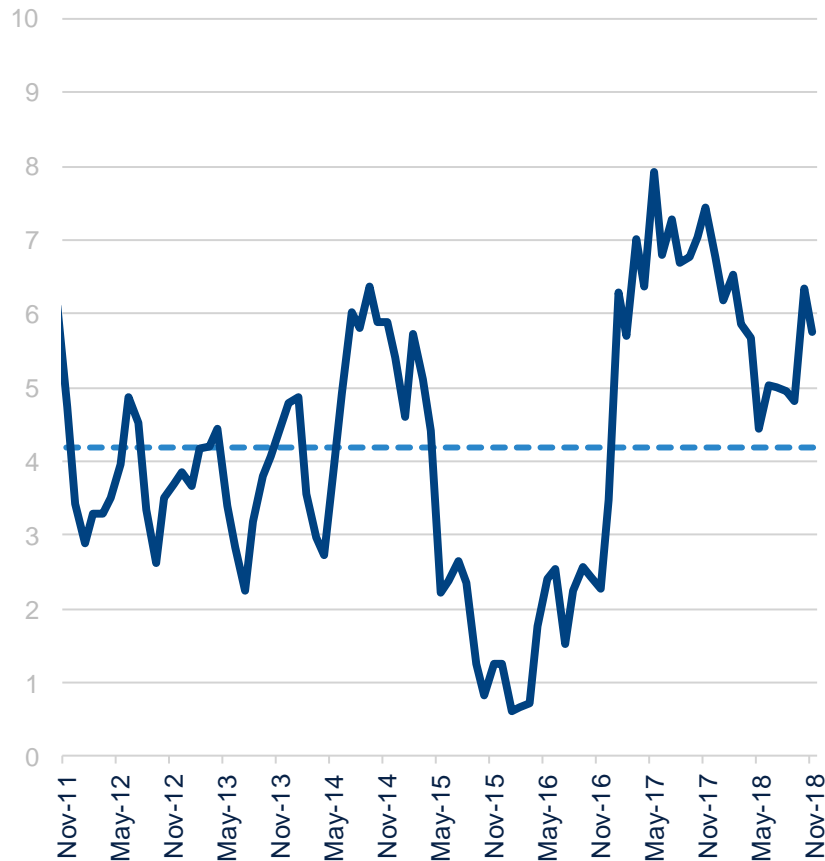


- Global growth is decelerating, but it remains solid
- The generalized deterioration of industrial production and trade suggest a more evident impact of protectionism
- The strong moderation of industrial confidence extends to other sectors, but the growth of private spending remains
- The high uncertainty continues at the beginning of the year and will continue to weigh on the growth

Global trade: effect of both increased tariffs and uncertainty on trade negotiations are now more evident

BBVA – Global exports of goods

(% YoY, 3-period moving average, nominal exports)

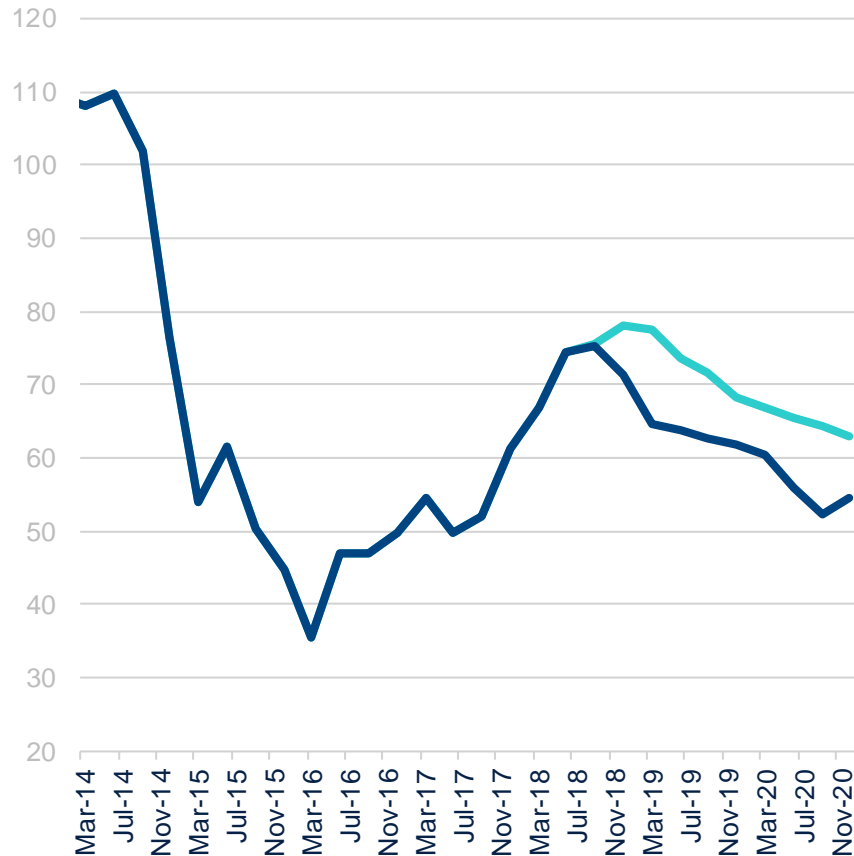


- World trade has shown **strong volatility** due to **uncertainty about trade disputes**
- The recent **poor performance of exports in China** is partly due to the previous front-loading of exports triggered by the possibility of new tariff increases, but its downward trend is worrying
- The worse-than-expected evolution of exports has also been observed in the **rest of Asia** and in **Germany**

Lower oil prices could drive global growth up by between one and two tenths in 2019-20

Oil prices

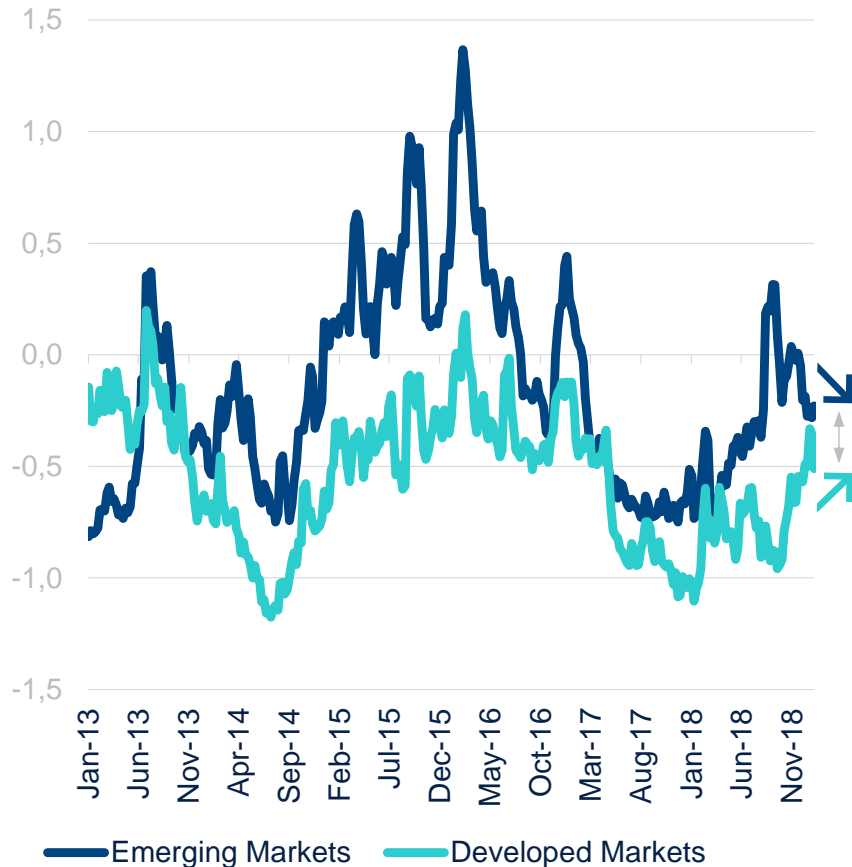
(Brent, USD per barrel)



- Oil prices may recover in the short term due the announced production cuts
- However, the growing production in the US and lower global demand will push prices downwards more than expected throughout 2019-20
- The fall in prices will benefit world growth, but the effect on some Latam countries will be negative
- Copper forecasts were revised downwards, due to lower world growth, while soybean forecasts were adjusted upwards, due to the prospects for relaxation in the China - US trade relationship

Recent turmoil in the financial markets due to a risk of a sudden adjustment of global growth

BBVA's Financial Tensions Index (Index)



01



Developed markets (US) are at the center of the episode, where financial tensions have rebounded sharply

02



EM remained relatively resilient despite the global mood and the fall in oil prices

03



Investors have withdrawn **sizeable outflows from DM**, but EMs have failed to attract new flows

04



The **response of central banks**, particularly the Fed showing higher prudence/patience, has been key to halt tensions

Still soft landing, but more uncertain due to dependence on policies

Worse macro outcomes

Faster slowdown than expected
(Protectionism+China)

Evidence that impact from **US fiscal stimulus** will fade earlier than expected



Higher financial stress

Risks of global growth hard landing

Tougher financial conditions



Three key assumptions in our projections:



01
Easing US-China trade tensions with no changes in the auto sector

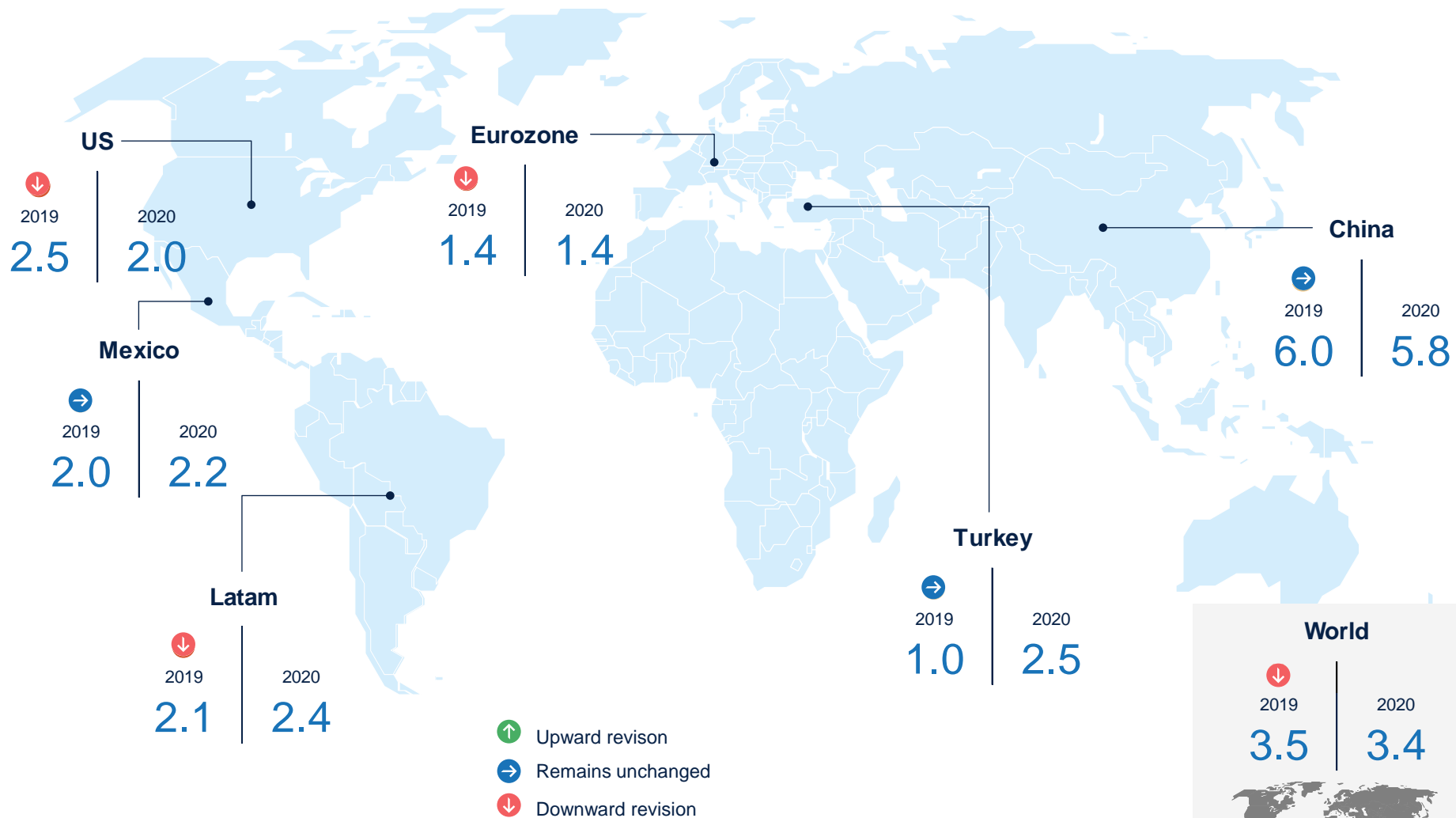


02
Orderly Brexit

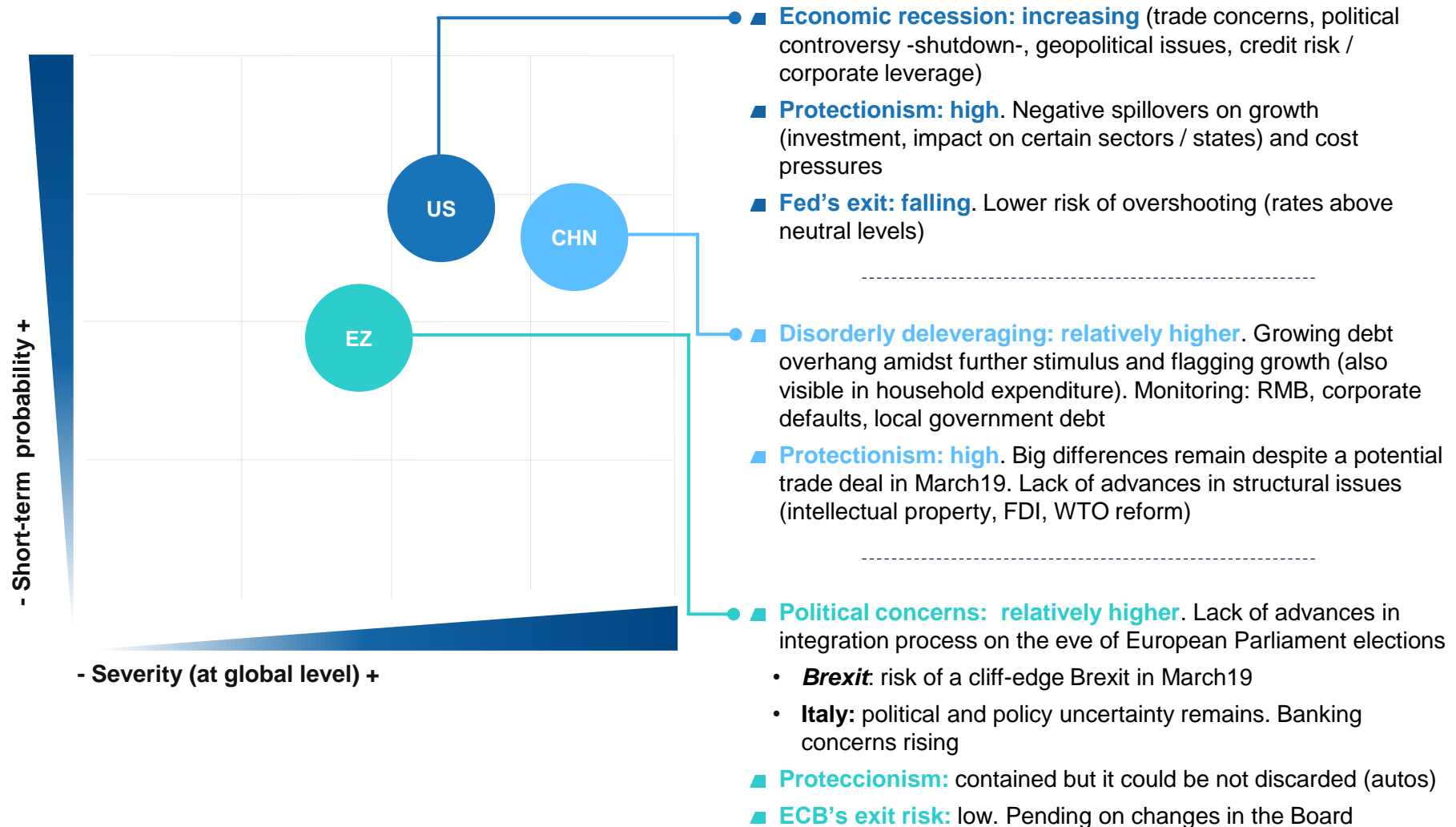


03
Fed and ECB: more dovish and with more room of maneuver

Widespread downward revision of growth, with moderation more evident in developed and emerging Asian countries



Global risks tilted to the downside: US recession fears, China's debt and trade war are the main sources of concerns





02

**Turkey: Stabilization in financial markets.
Real economic adjustment gains momentum**

Policy determination remains critical to anchor expectations and achieve further stability. The margin for policy mistakes is slim

01



Turkish financial assets stabilized after the firm policy responses and easing geopolitics. We don't expect policy slippages as the margin is slim

02



The real adjustment is underway with some signs of bottoming out. The recovery will accelerate during the second half of the year

03



Rebalancing is sizeable with credit and external imbalances vanishing. Inflation will correct more rapidly after the summer

04



The Central Bank will remain tight until inflation expectations clearly correct. We expect the start of the easing cycle in June

05



Despite challenging fiscal targets, the Government will stick to the Fiscal Consolidation path increasing reliance on “one-offs”

06



A more balanced foreign affairs with US & Europe will support financial assets. Some uncertainties remain after the US withdrawal from Syria

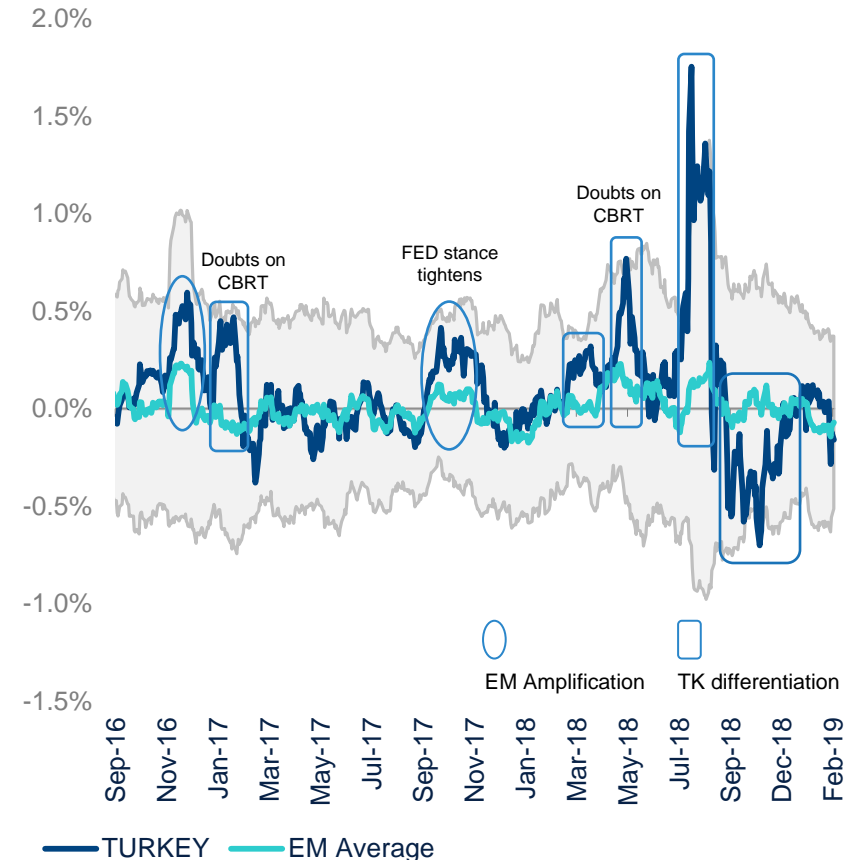
Firm policies and eased foreign affairs tensions with the US have supported the stabilization of Turkish financial assets

Turkish Lira vs USD (Level)



EM Currencies volatility

(% daily change moving average 1M moving Avg. One Standard deviation range)



Source: BBVA Research

(*) A positive value indicates a depreciation of the local currency.
Source: Bloomberg

The real adjustment of economic activity is underway and accelerating in 4Q18 according to the high frequency indicators

Turkey: Activity Indicators

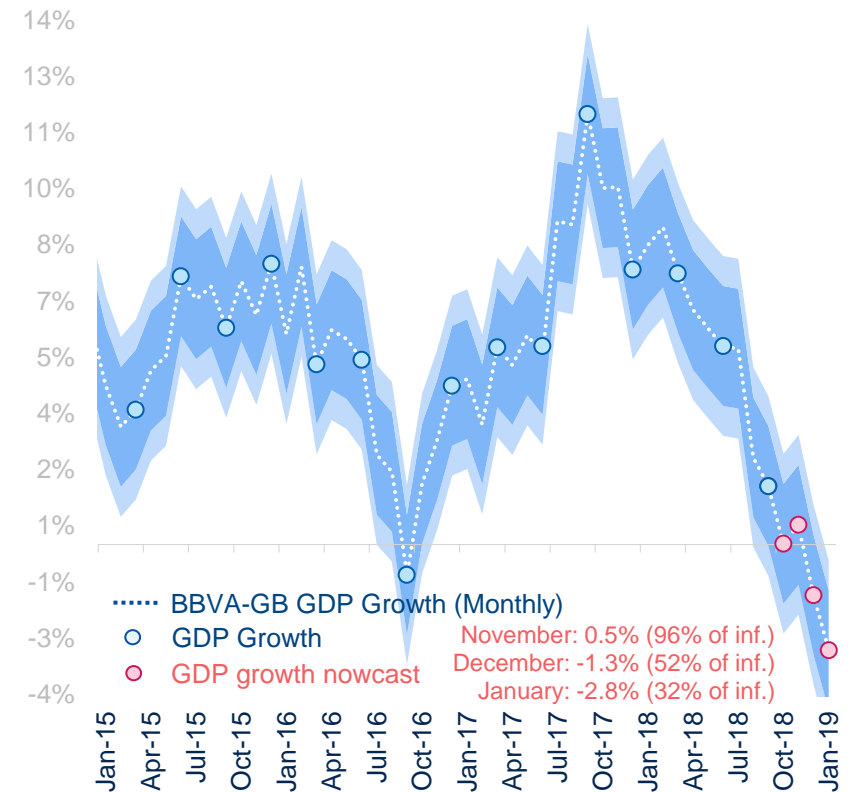
(%YoY, mov. Avg. 3m)

	2018								2019
	Mean	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Industrial Production	7.6	5.0	6.0	-0.2	0.6	-3.5	-2.2		
Non-metal Mineral Production	7.4	3.1	2.8	-4.8	-4.0	-10.7	-11.4		
Electricity Production	4.7	2.0	1.8	0.5	0.2	-1.2	-0.9	-1.8	-1.8
Auto Sales	5.7	-20.0	-29.6	-42.1	-51.5	-66.5	-61.2	-52.4	
Tourist Arrivals	5.9	28.3	21.0	17.7	14.7	18.8	20.5	20.8	
Number of Employed	3.9	2.5	2.1	1.9	1.5				
Number of Unemployed	1.7	-2.3	0.6	4.1	6.7				
Auto Imports	7.3	-21.2	-35.3	-50.9	-59.3	-69.9	-61.0	-53.0	
Auto Exports	9.1	37.3	24.3	9.5	5.3	4.8	10.9	1.9	
Retail Sales	6.0	5.8	4.5	1.8	0.0	-3.5	-4.8	-5.5	-5.8
Manufacturing PMI	51.2	48.4	49.6	46.4	42.7	44.3	44.7	44.2	44.2
Total Loans growth 13-week	18.2	14.2	9.3	1.9	-3.5	-8.1	-9.1	-9.5	-7.9
Real Sector Confidence	106.1	104.6	102.7	96.4	89.6	87.6	92.8	91.5	93.0
MICA Forecast GDP YoY						0.0%	0.5%	-1.3%	-2.8%

Contraction Slow-down Growth Boom

Turkey: GDP Monthly Indicator

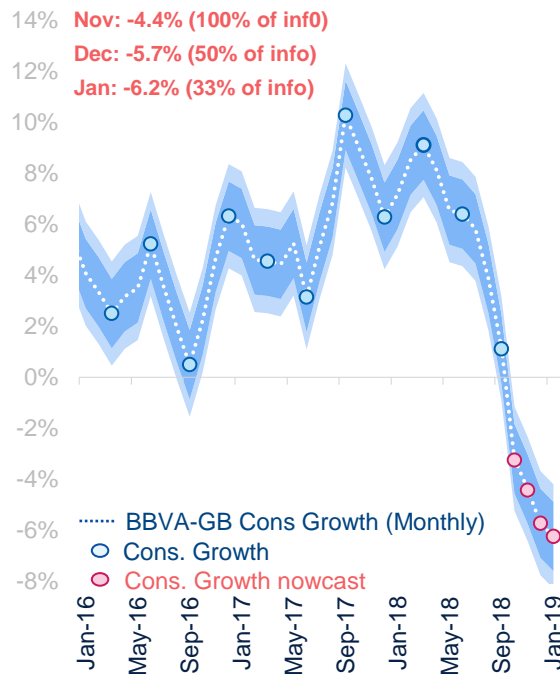
(%YoY mov. Avg. 3m)



The rebalancing of economic activity is significant: The sharp contraction in domestic demand is partially compensated by a sizeable reversal of external demand contribution

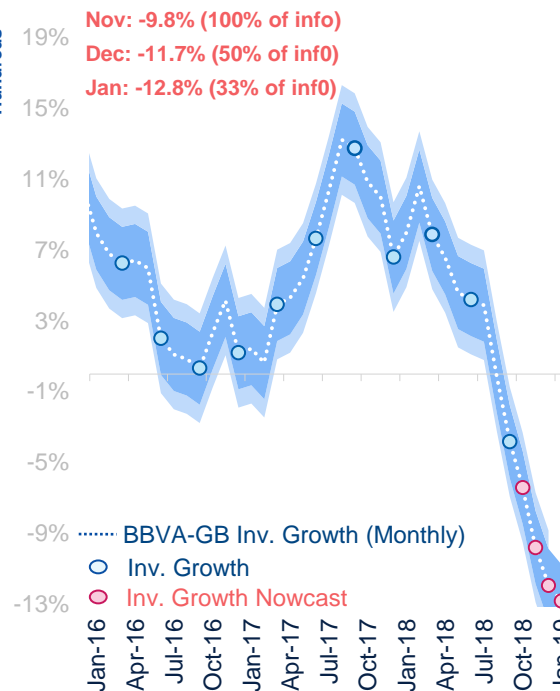
Turkey: Private Consumption

(%YoY, mov. Avg. 3m)



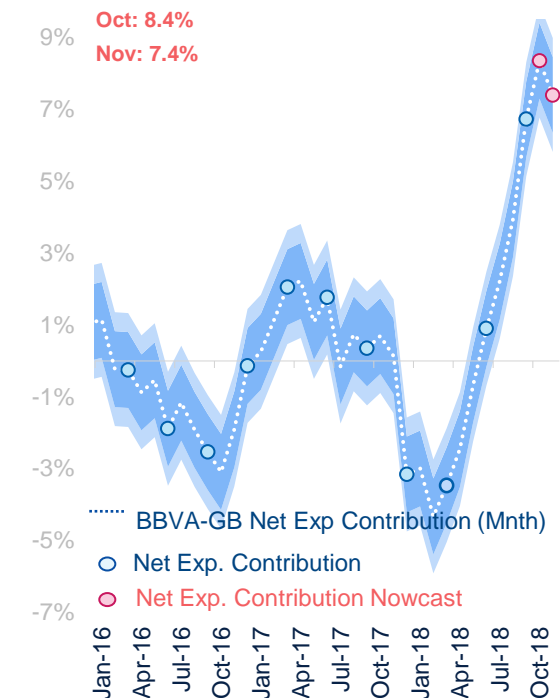
Turkey: Total Investment

(%YoY, mov. Avg. 3m)



Turkey: Net Exports

(% Contribution to GDP Growth)



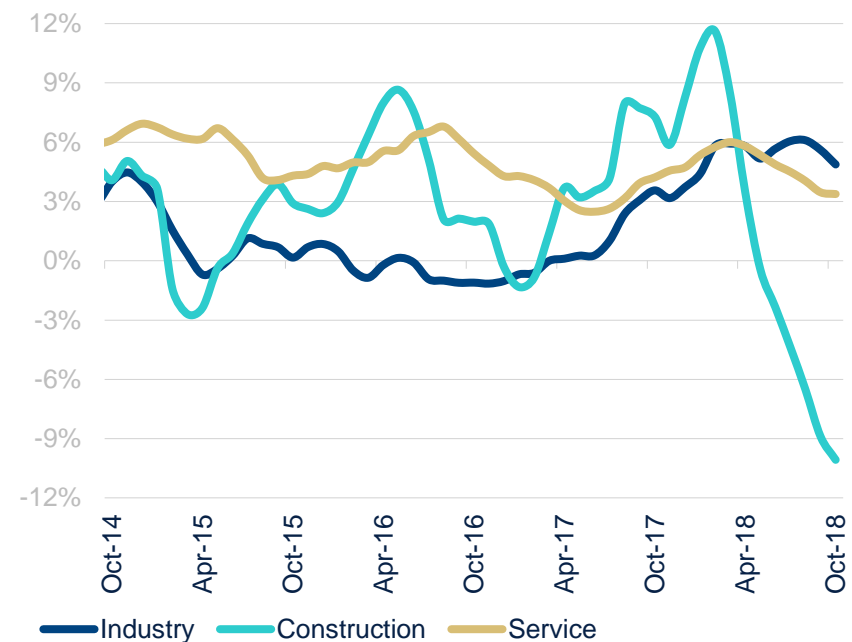
The unemployment rate is rising as a result of the end of the Credit Guarantee Fund, the increase in labor force participation rate and the business cycle deterioration

Turkey: Unemployment Rate
(SA, %)



Source: TURKSTAT, BBVA-Research Turkey

Turkey: Employment Growth by Sector
(3MA yoy)



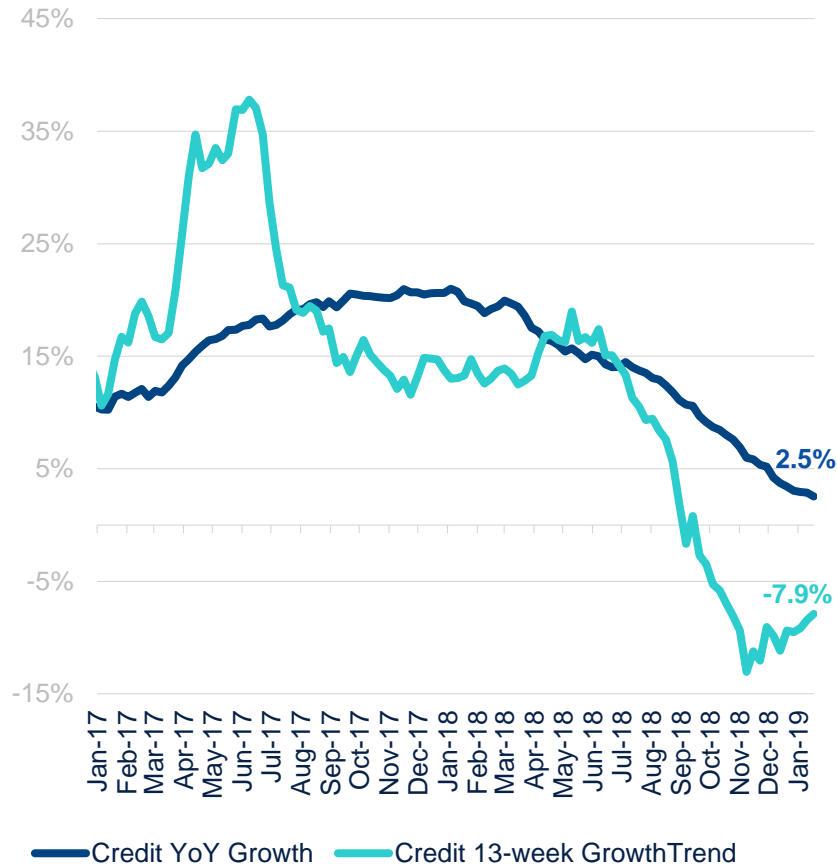
New participants to the labor force and the loss of momentum in job generation due to business cycle conditions led to the recent increase in the unemployment rate

Employment growth in services and industrial sectors compensate the losses in construction employment so far

The credit correction is still alive but bottoming out from very negative growth rates...

Credit Growth (FX adj)

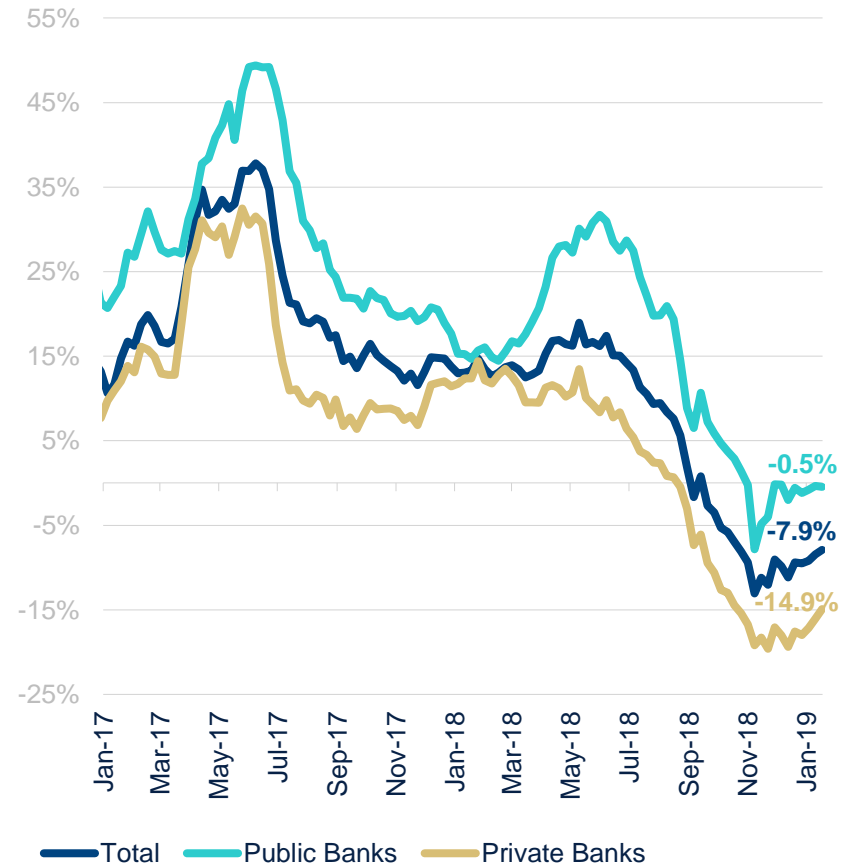
YoY, 13-week Quarterly Annualized Rate



Source: CBRT, TURKSTAT, BBVA-Research Turkey

Credit Growth (FX adj)

13-week Quarterly Annualized trend

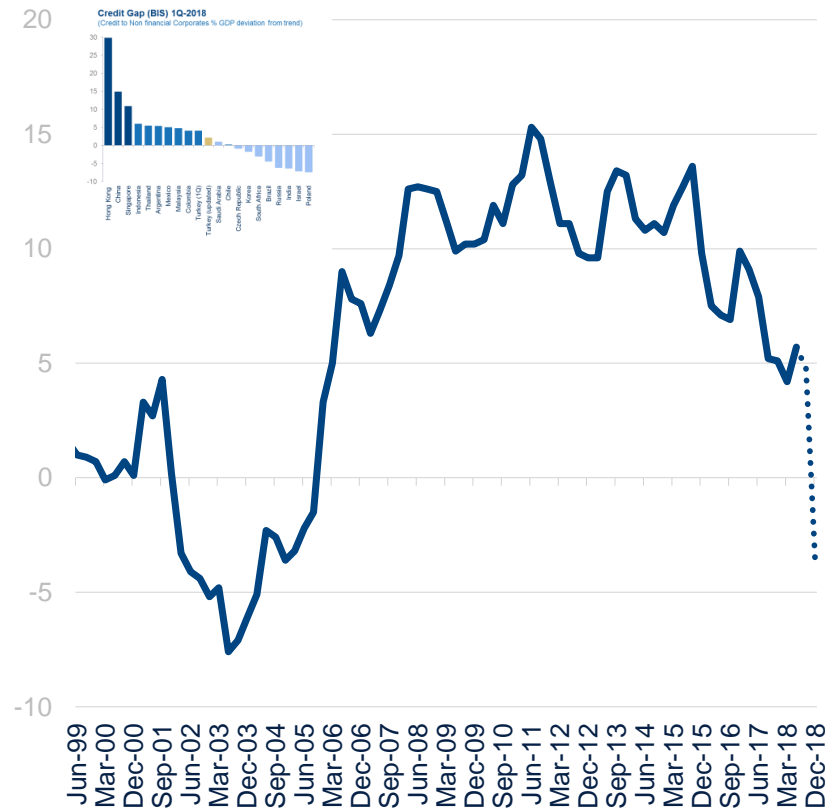


Source: CBRT, TURKSTAT, BBVA-Research Turkey

These have prompted a rapid correction of internal and external imbalances: the Credit Gap and the current account deficit are virtually disappearing in tandem

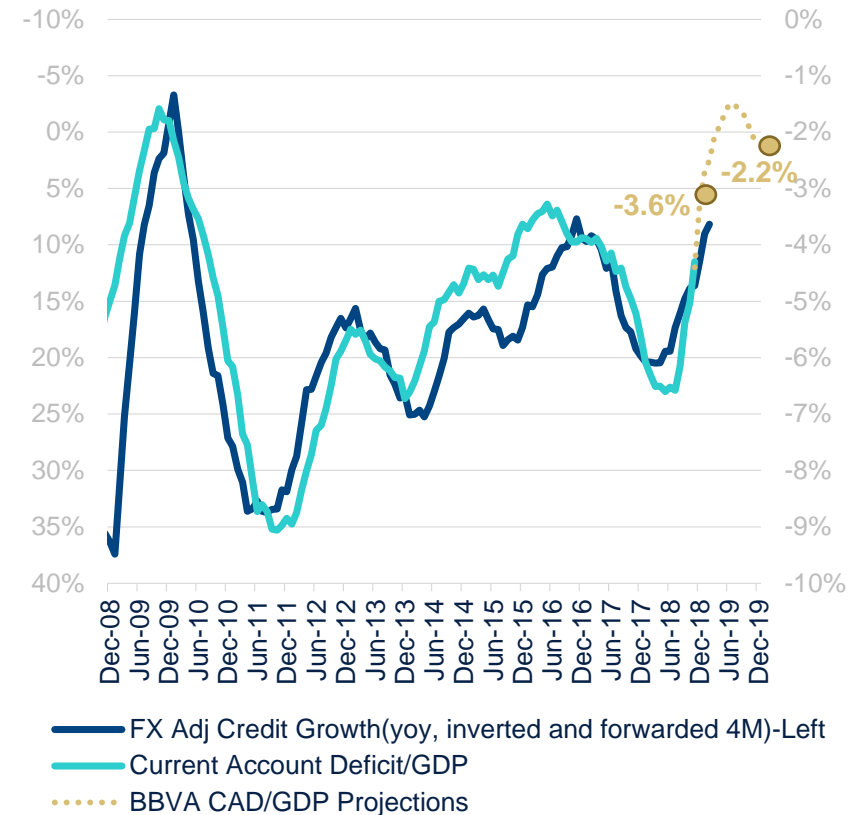
Turkey: Credit Gap (BIS)*

(Credit to Non financial Corporates % GDP deviation from trend)



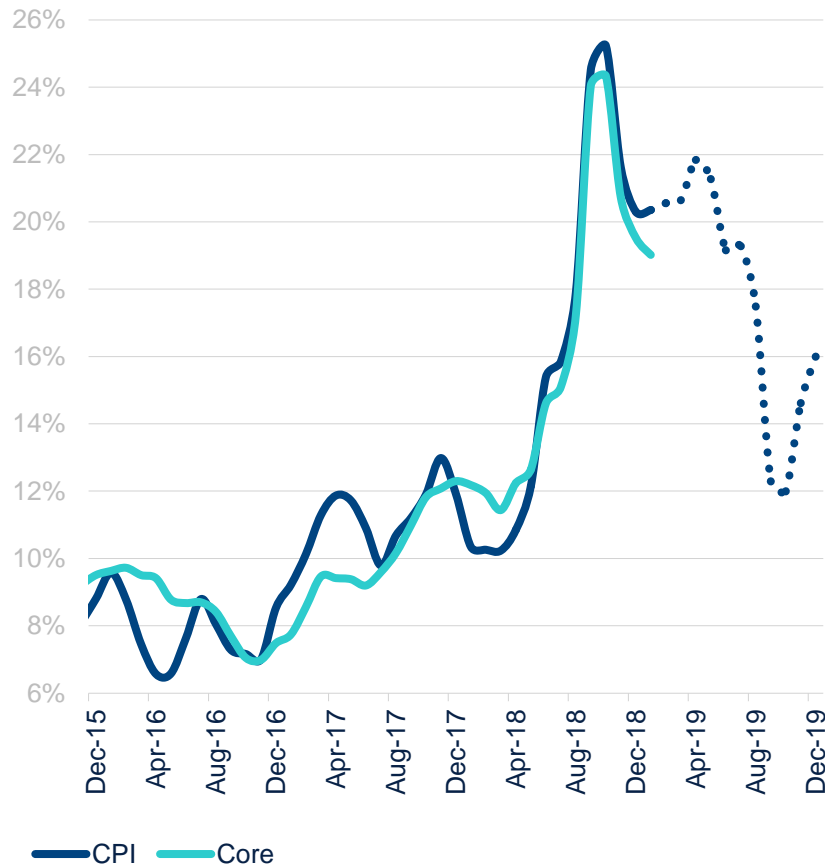
Turkey: Current Account and Credit Growth

(% GDP and Credit YoY inverted and forwarded 4 months)



The disinflation path has started and will gain momentum in the second part of the year

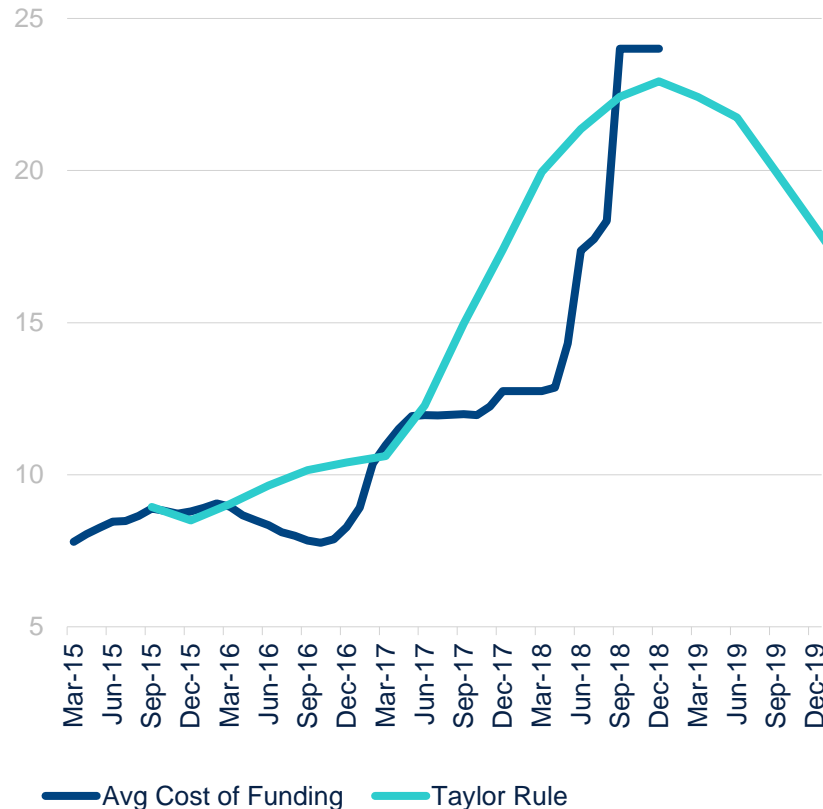
Turkey: CPI and Core C Inflation
(YoY)



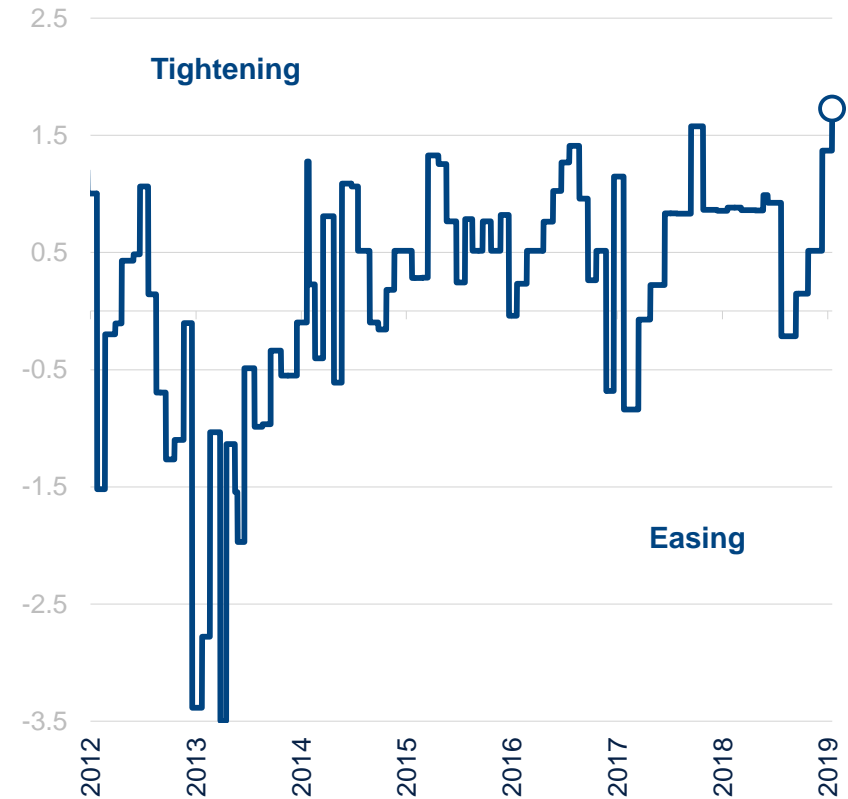
- The extension of tax incentives, the dying-out exchange rate pass-thru and negative output gap have supported the beginning of the disinflation path
- An acceleration of this trend will become more obvious in the second half of the year once the base effects support
- The net effect of extra factors as utility price reductions, higher-than-expected increase in minimum wage and the tax increase in tobacco pose some uncertainty on the projections

The Monetary Policy Stance remains tight with words and deeds. We expect the easing cycle to start around summer once the credibility is restored and inflation (and expectations) start to recede

Turkey: CBRT Policy Rate and Taylor Rule
(3Q center average NK Taylor rule)

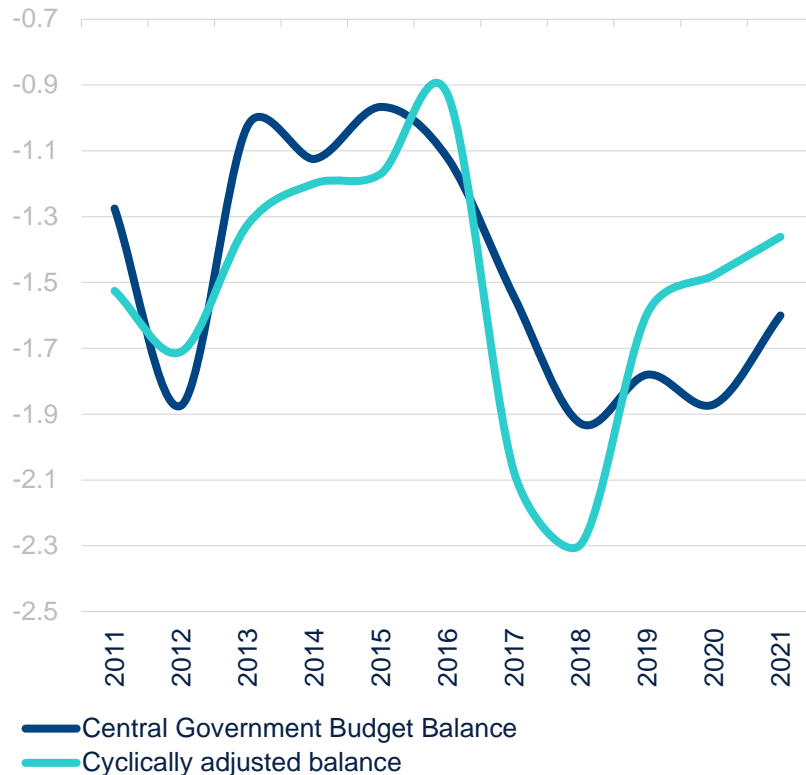


Turkey: CBRT Monetary Policy Sentiment Index
(Using Big Data Techniques)



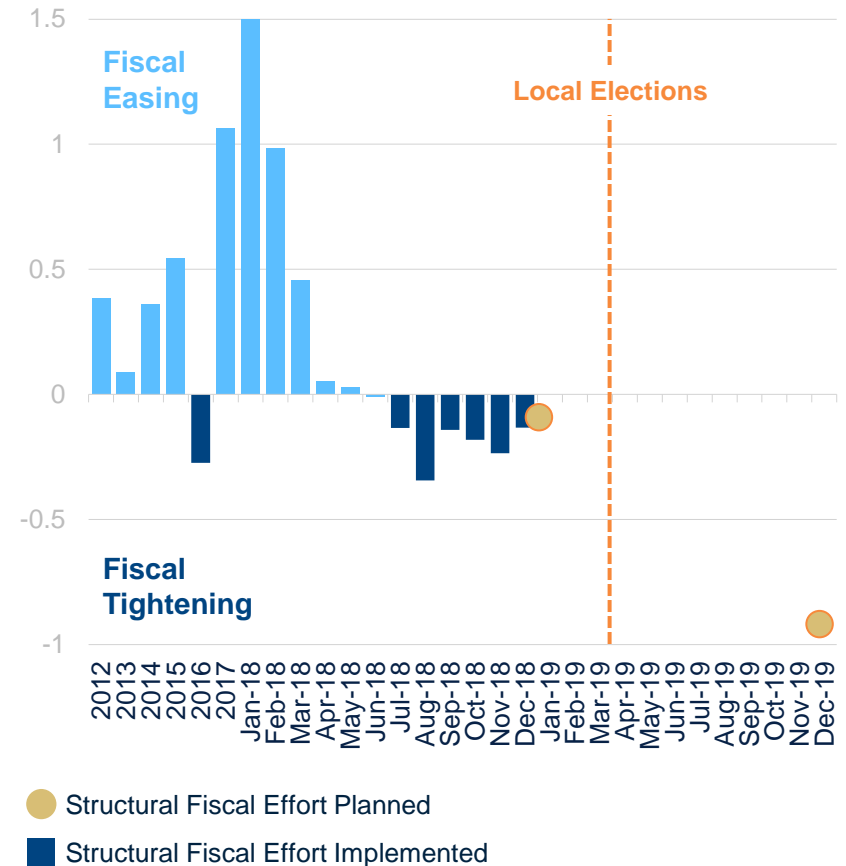
The Fiscal Policy will be closely monitored by the markets since fiscal targets will be more challenging in 2019

Turkey: CG Budget Balance and NEP Forecasts
(% of GDP)



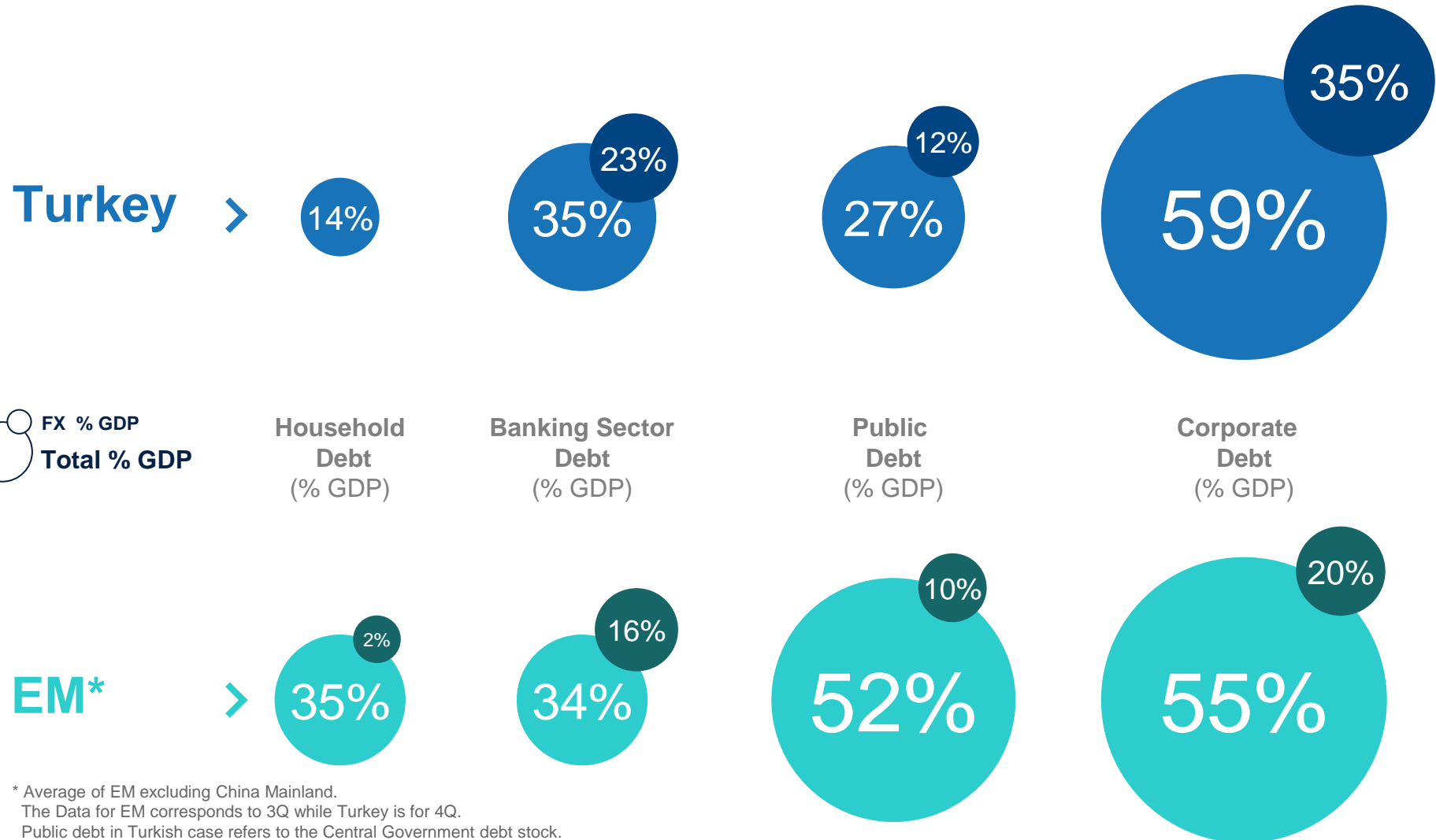
* The 2019 savings amount 60bnTL (1.3% of GDP) coming from: postponing investment (0.7% of GDP), reducing incentives (0.3% of GDP), cutting social security (0.2% of GDP), lowering current expenditures (0.1%).
 ** On the revenues side, extra tax revenues are targeted (0.4% of GDP) in 2019
 *** Higher interest expenditures in 2019 (2.8% of GDP up from 2.0% in 2018).

Turkey: Fiscal Effort Tracker
(12m Cumulative change in cyclically adjusted balance, % GDP)



*2018 figures correspond to 12-month sum.

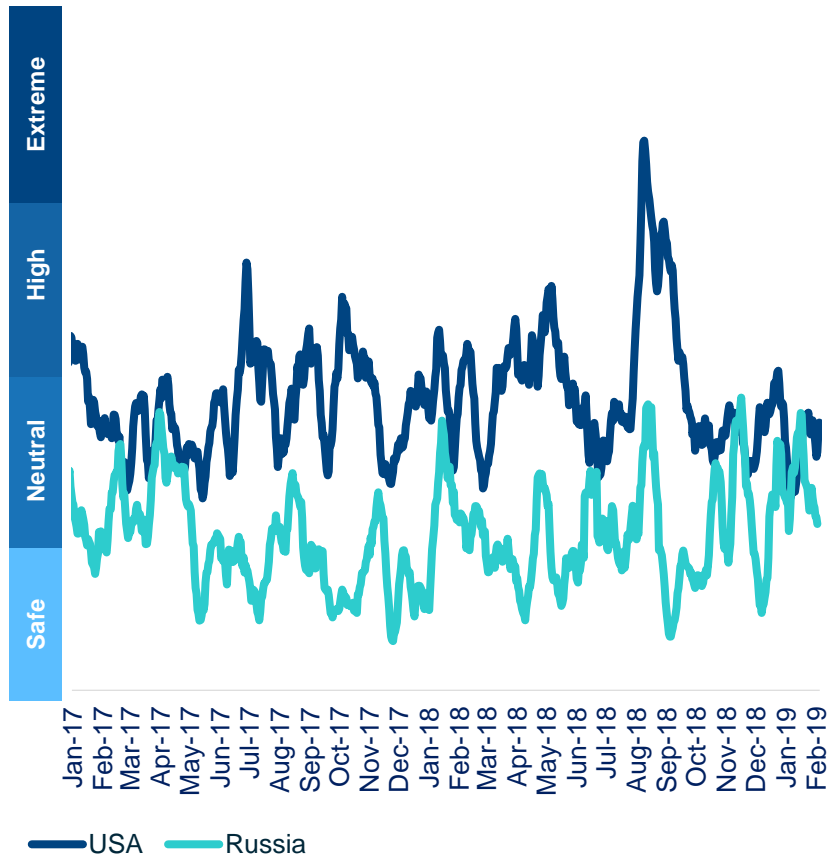
The high share of foreign currency in corporate debt remains the key issue. It will be necessary to advance in corporate restructuring



* Average of EM excluding China Mainland.
 The Data for EM corresponds to 3Q while Turkey is for 4Q.
 Public debt in Turkish case refers to the Central Government debt stock.
 Trade credits are excluded from corporate debt, 6% of GDP as of November.
 Banking sector debt refers to non-core liabilities.
 Source: BBVA Research, BIS, IMF, IIF

The recent improvement in Turkey-US relations have helped to remove uncertainties

Turkey: foreign Relationships Index (Sentiment level index using Big Data techniques)



- U.S. Withdrawal decision from Syria eased the tensions between Ankara and Washington
- Nonetheless, Turkey still expects U.S. to pull its support from YPG and still keeps the option for unilateral action
- Russian officials' pro-Assad announcements contradict Turkey's Syria strategy
- Turkey-Iran-Russia will meet in February to discuss Syria which could limit uncertainties

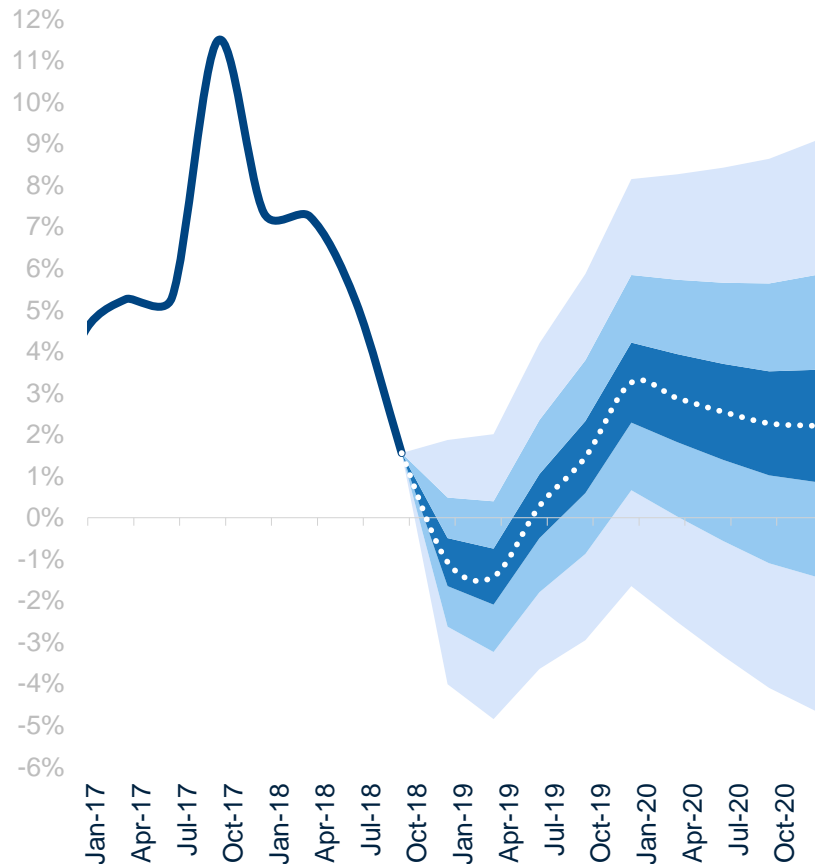


03

Turkey Baseline Scenario

We maintain our GDP growth estimates but with some downside risks

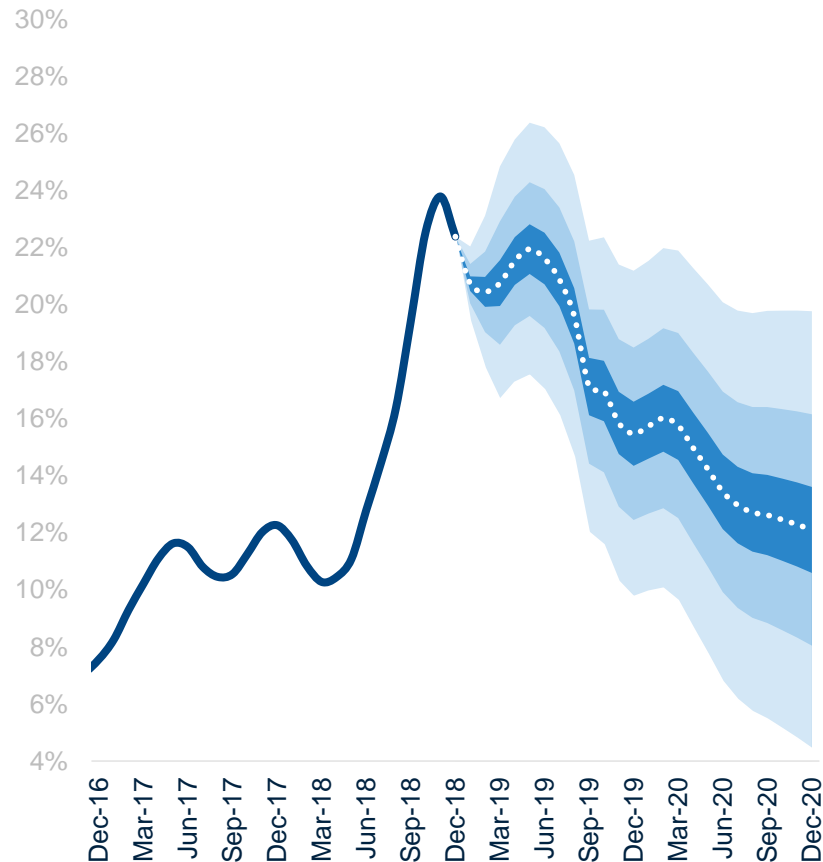
GDP Forecast
(YoY)



- The economic activity is rebalancing and the adjustment accelerated during 4Q18
- The most recent high frequency indicators show some signs of bottoming out
- Uncertainty about the effects of corporate restructuring in economic activity remains. Relatively calm financial markets will facilitate the restructuring process
- We expect GDP growth to be 3% in 2018 with some downside risks and fall further to 1% in 2019

Inflation will come down due to tight policies, easing currency pass-thru, negative output gap and supportive oil prices

Consumer Inflation Forecast (3m YoY)

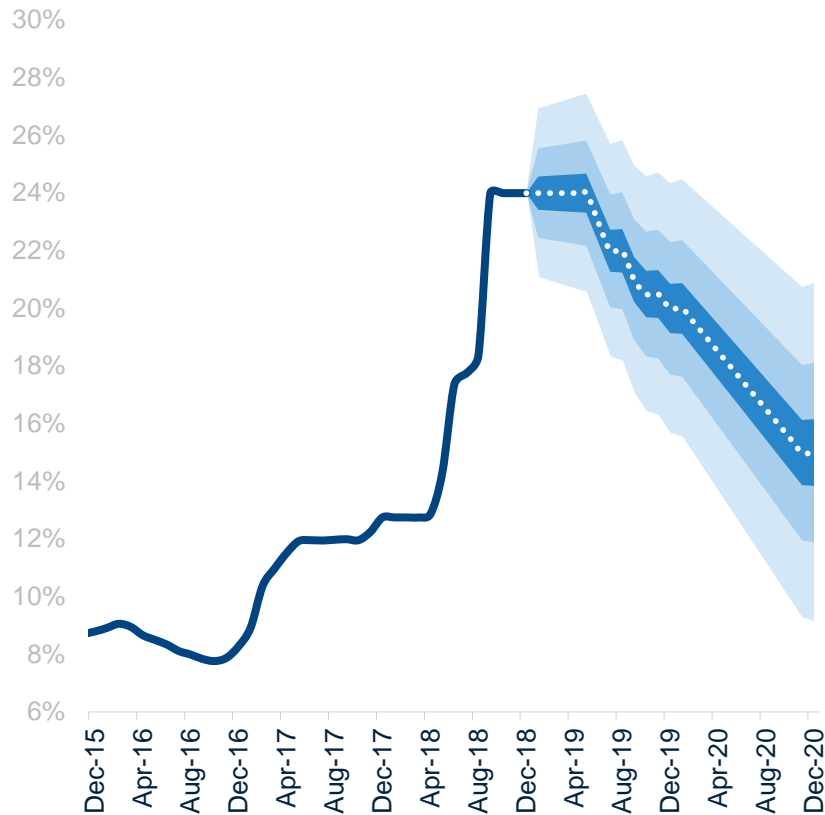


- High volatility in the markets, uncertainties over the pricing behavior and cost push factors including food inflation will maintain inflation high in 1Q19
- The disinflation path will accelerate during summer once the pass thru from the exchange rate starts to vanish, negative output gap deepens and base effects become supportive
- We estimate that the inflation will stay above 20% in the first half of the year to and reduce near 16% and 12% at the end of 2019 and 2020 respectively

We maintain a prudent forecast for the exchange rate given global uncertainties and political elections. The Central Bank might start the easing cycle in June

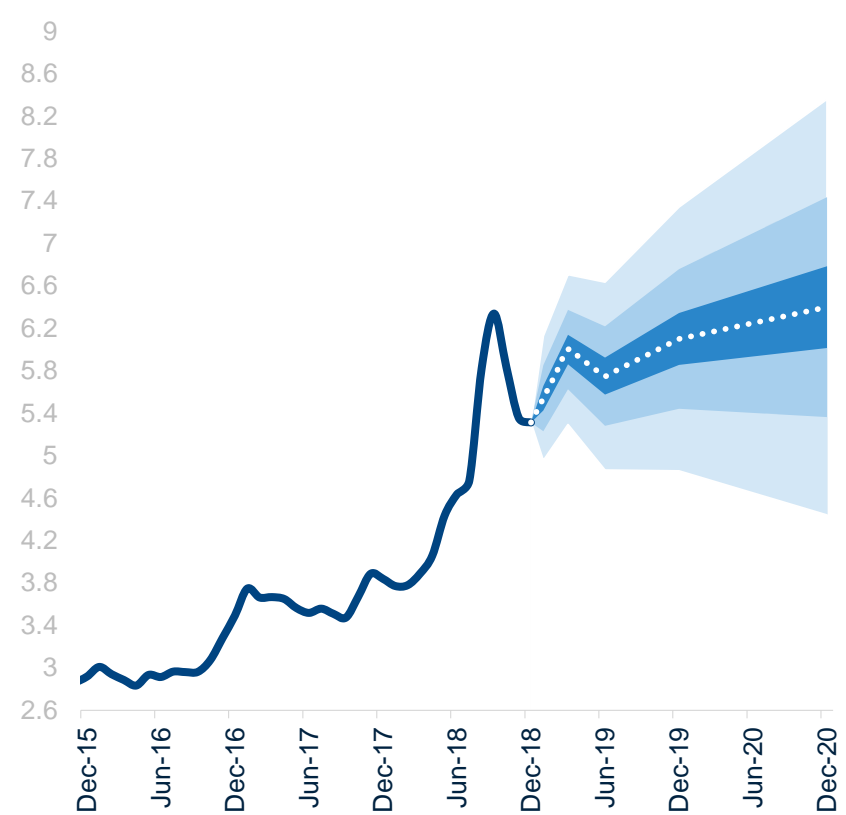
Monetary Policy Forecasts

(% CBRT Funding Cost)



Exchange Rate Forecasts

(USDTRY Level)



Turkey Baseline Scenario

	2017	2018 (e)	2019 (f)	2020 (f)
GDP (%)	7.4	3.0	1.0	2.5
Private consumption (%)	6.1	3.4	0.4	1.9
Public consumption (%)	5.0	4.9	3.5	3.0
Investment in fixed capital (%)	7.8	-1.7	-6.6	2.3
Exports (%)	11.9	5.9	6.0	6.0
Imports (%)	10.3	-3.6	-3.2	5.0
Unemployment rate (average)	10.9	11.3	13.5	12.8
Inflation (end of period, YoY %)	11.9	20.3	16.0	12.0
CBRT funding rate (end of period, YoY %)	13.4	24.0	20.0	15.0
Exchange rate (USDTRY, end of period)	3.77	5.28	6.10	6.40
Current account balance (% of GDP)	5.5	-3.6	-2.2	-2.0
Central government budget balance (% of GDP)	-1.5	-1.9	-2.2	-2.0

(f) Forecast. (e) Estimated.

Source: BBVA Research Turkey

This report has been produced by:

Chief Economist for Turkey

Álvaro Ortiz

alvaro.ortiz@bbva.com

Seda Güler Mert
sedagul@bbva.com
+90 212 318 10 64

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

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

Serkan Kocabas
serkankoc@bbva.com
+90 212 318 10 57

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

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

Pelin Ayrancı
pelinayr@bbva.com
+90 212 318 10 58

With the collaboration of:

Economic&Financial Forecasting

Sonsoles Castillo
s.castillo@bbva.com

Miguel Jiménez
mjimenezg@bbva.com

Sumedh Deorukhkar
sumedh.deorukhkar@bbva.com

Enestor dos Santos
enestor.dossantos@bbva.com

Rodrigo Falbo
rodrigo.falbo@bbva.com

Agustín García
agustin.garcia@bbva.com

Iñaki Martínez
ignacio.martinez.urios@bbva.com

María Martínez
maria.martinez.alvarez@bbva.com

María Moraga
maria.moraga@bbva.com

Juan Navarro
juan.navarro.bermejo@bbva.com

Cecilia Posadas
c.posadas@bbva.com

María Victoria Ramírez
mariavictoria.ramirez@bbva.com

Cristina Varela
cvarela@bbva.com

The logo for BBVA Research, featuring the text "BBVA" in a bold, white, sans-serif font, followed by "Research" in a smaller, lighter weight sans-serif font. A small teal square is positioned to the right of the word "Research".

BBVA Research

Turkey Economic Outlook 1Q19

February 2019

Creating Opportunities