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# **Turkish Economy in Early 2017**

## **An Update on Recent Developments and Some Speculations on the Future**

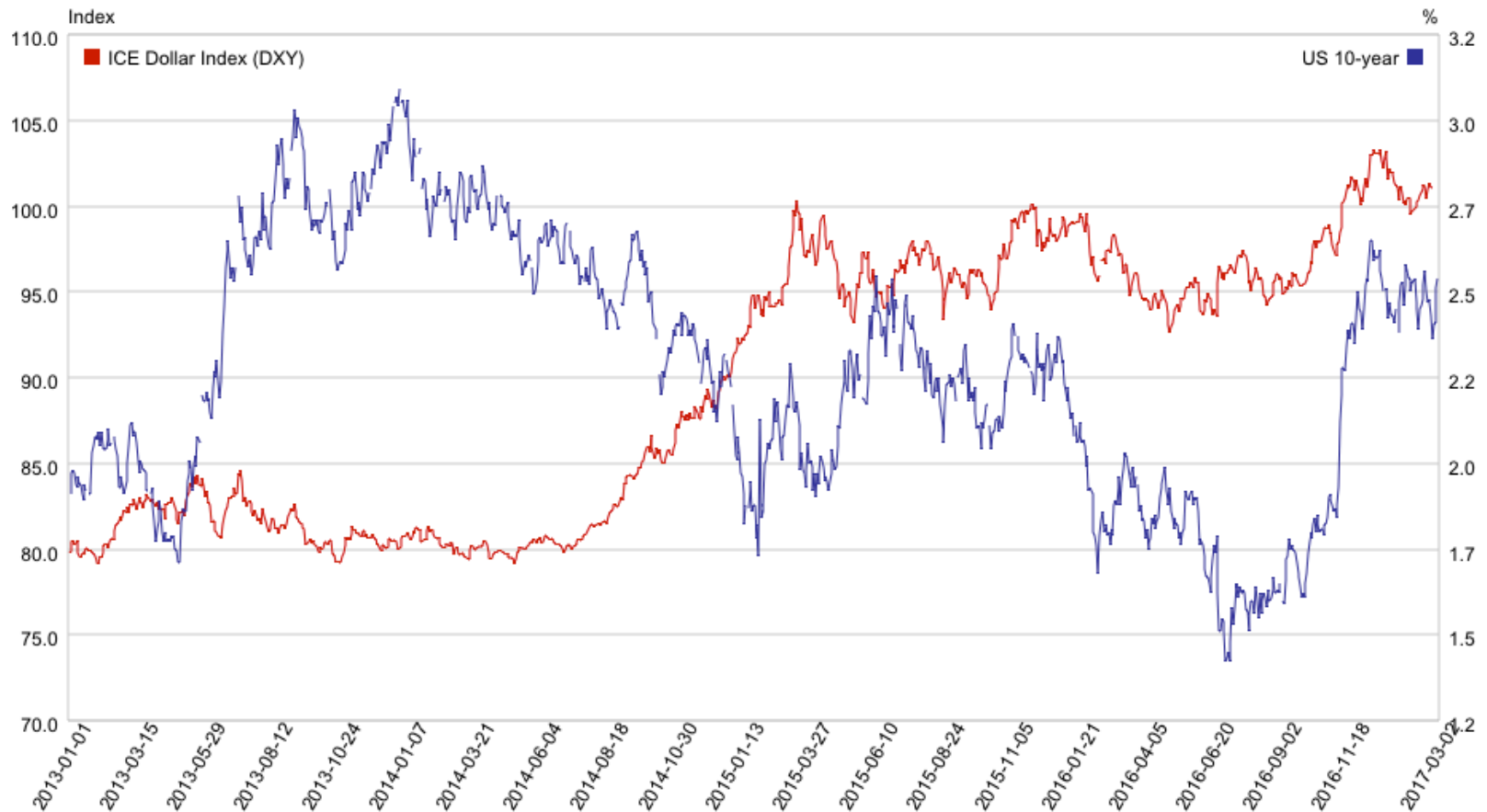
**E. Murat Ucer**  
**March 3, 2017**

# Outline

- A few thoughts on the global landscape...
  - Improving growth environment, the Trump phenomenon and the Fed hikes: uncertainty is the only certainty?
- A quick update on domestic developments...
  - Growth is slowing, but stimulus measures may boost it temporarily; inflation is rising, CAD is stable, exports are rising somewhat, financing is weak; monetary policy is buying time, budget is holding up...
- A first take on 2017...
  - All eyes on the referendum; an early election is quite likely, but muddle-through is the most likely scenario, either way...
- Speculations beyond 2017...
  - All depends on the global environment -- and domestic politics as well as policy outlook... What's the vision? Does it add up?

# Markets have been pricing “reflation”...

## U.S.: Dollar Index and 10-Year Rate



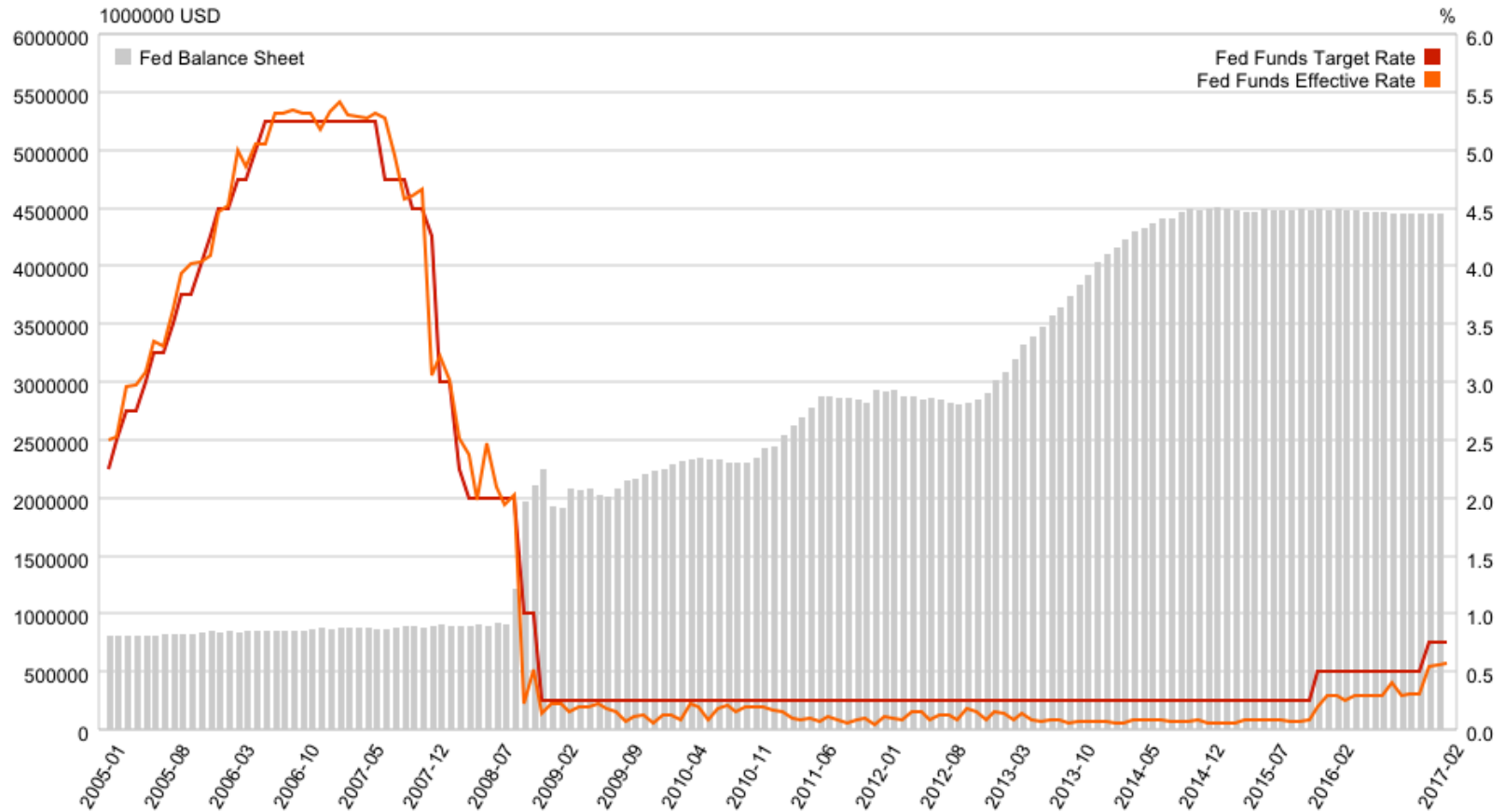
# Equity markets have been rallying...

## US Stock Exchanges

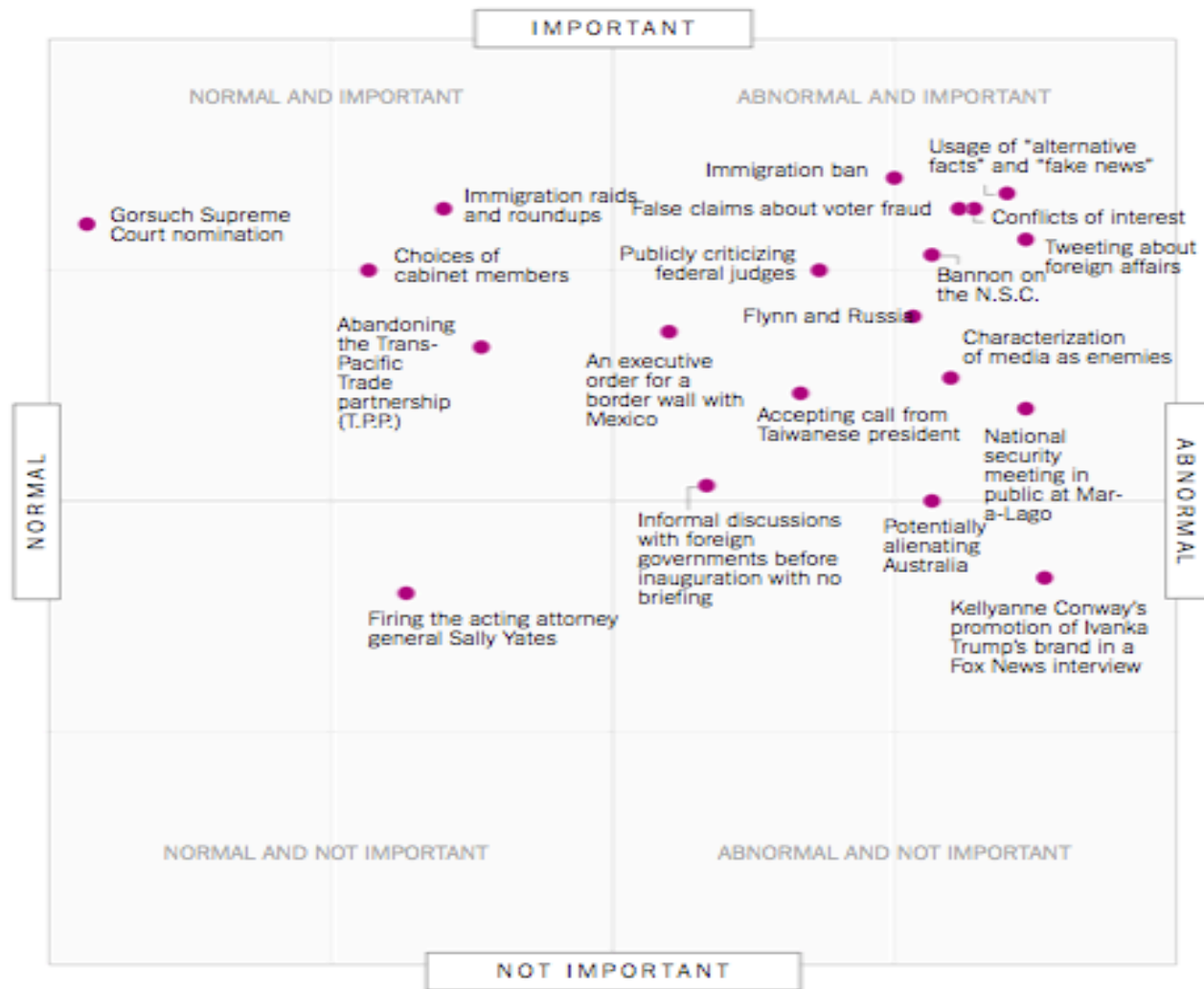


# Fed likely to hike 3 times this year, as in the December “dot plot”...

US Fed Funds Rate and the Fed Balance Sheet



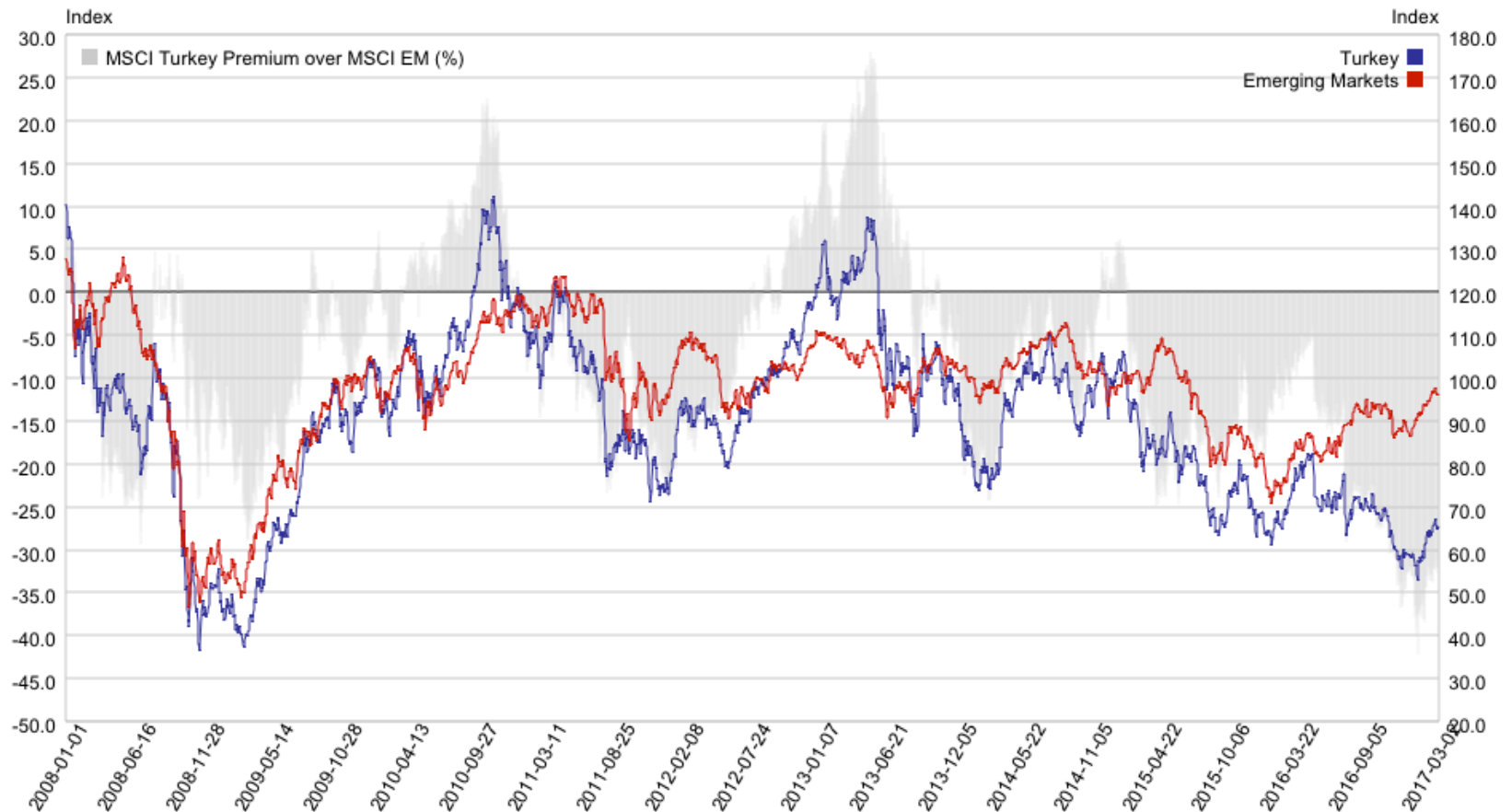
# But Trump-related uncertainty is huge...



Source: [www.nytimes.com/interactive/2017/02/27/upshot/whats-normal-whats-important-a-ranking-of-20-events-in-the-trump-administration.html](http://www.nytimes.com/interactive/2017/02/27/upshot/whats-normal-whats-important-a-ranking-of-20-events-in-the-trump-administration.html)

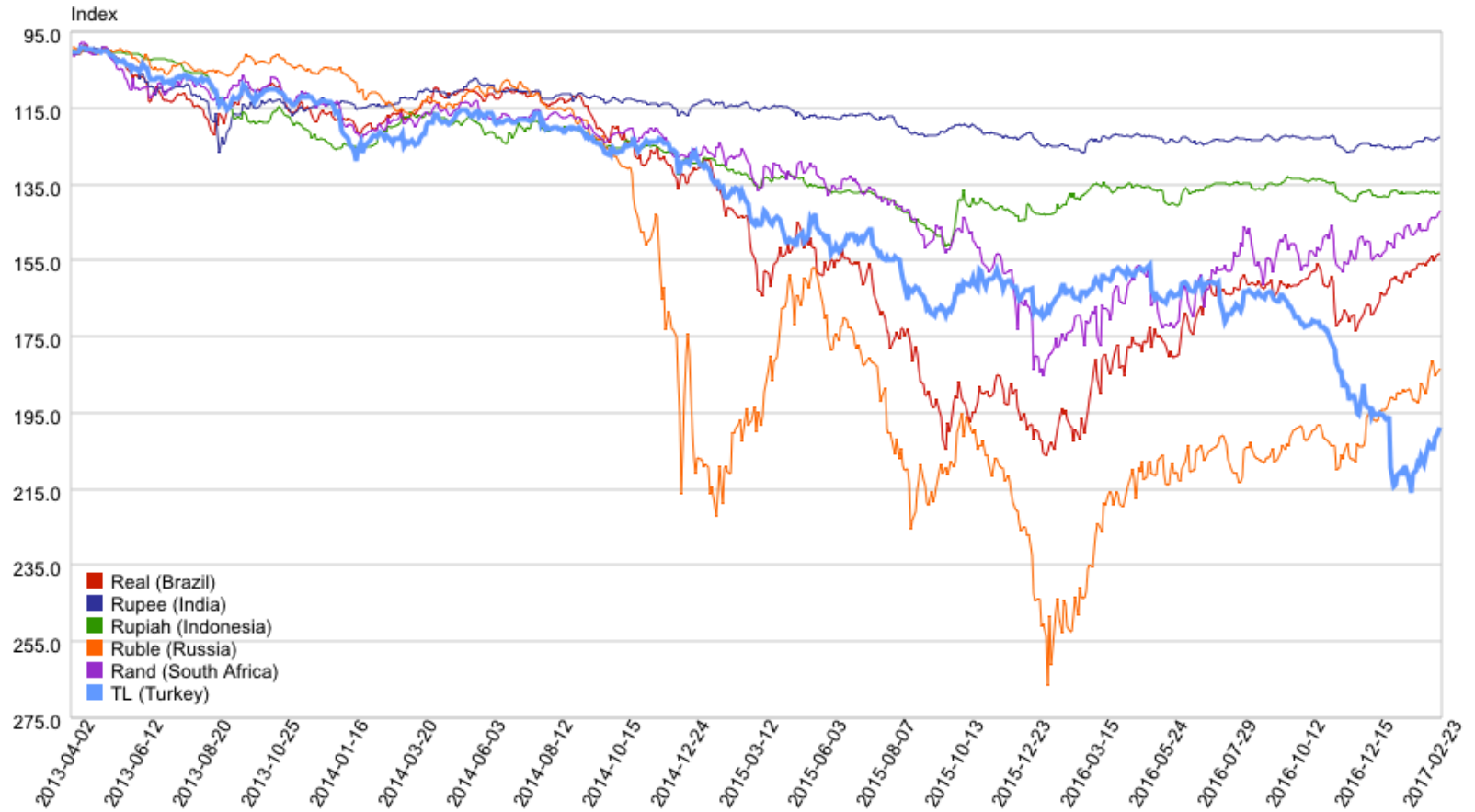
# We have also benefited from recent turnaround in sentiment...

MSCI: Turkey and EM (August 2008=100)



# Lira has also relatively stabilized

Selected Emerging Markets Exchange Rates (April 2013=100)



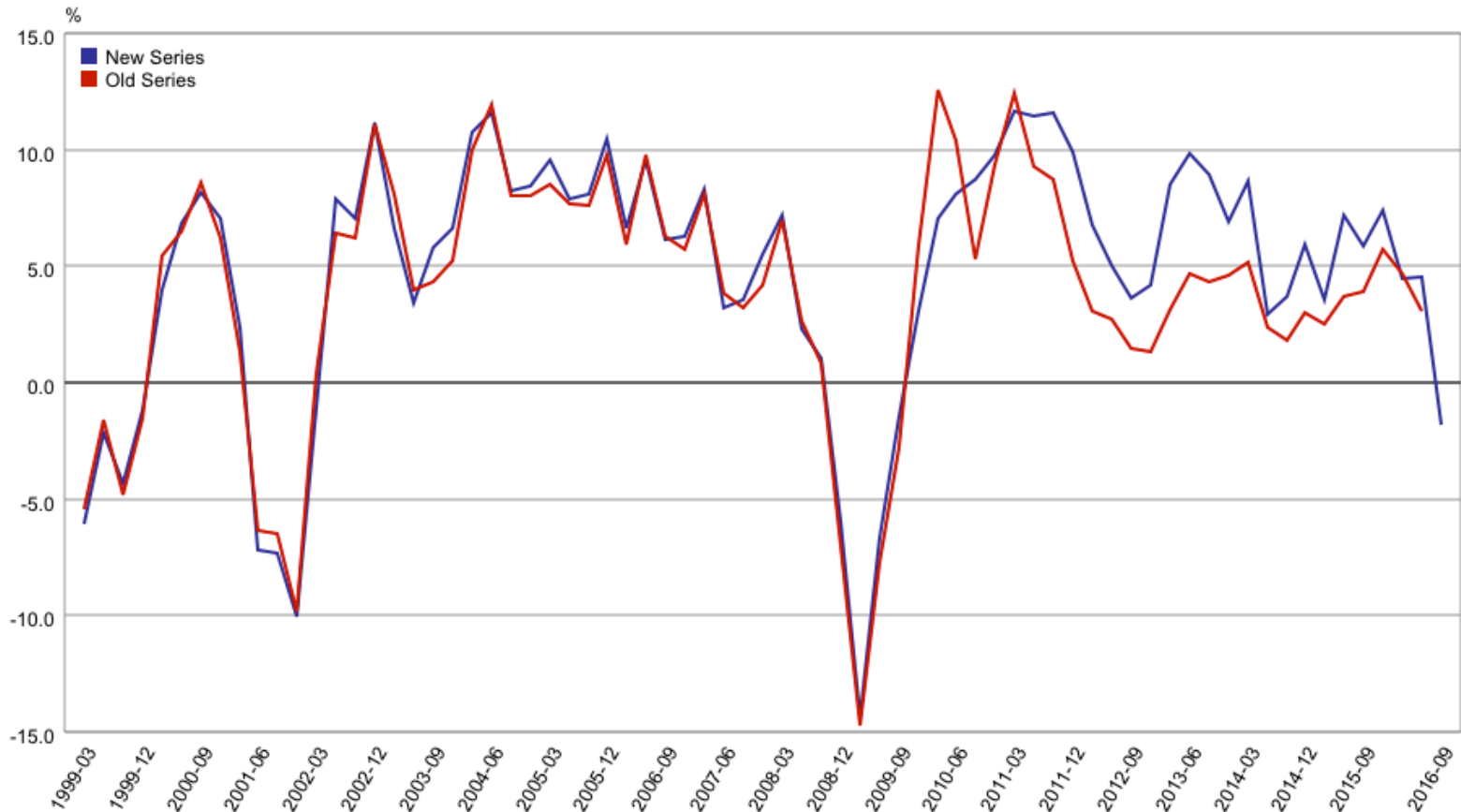


# Recent economic developments, in a nutshell...

- The economy was resilient until recently, but growth has weakened visibly since second half of last year...
- There is a structural slowdown in growth on the back of political uncertainty, lack of reform, lack of adequate inflows and so on...
- But the government is trying several measures that may boost growth in the short-run; this means fiscal loosening and growing inefficiencies later...
- Latest GDP revisions showed we were an “Asian Tiger” of sorts in recent years, but that was largely thanks to a construction boom, which does not change the broader story going forward...
- The CBRT has been buying time (till the referendum perhaps?); recent steps have helped to stabilize the lira, but this may prove temporary
- The lira underperformed because of politics, a high external financing requirement and ongoing political pressures on the CBRT
- Exports picked up recently, which is encouraging, but whether this will be sustained has yet to be seen
- Collateral damage from a weaker lira is high (inflation to rise in 2017, confidence is faring weak, currency mismatch is ailing corporates)

# Growth will rebound in Q4, but has weakened generally...

Gross Domestic Product: Old vs. New Series (real growth %, y/y)

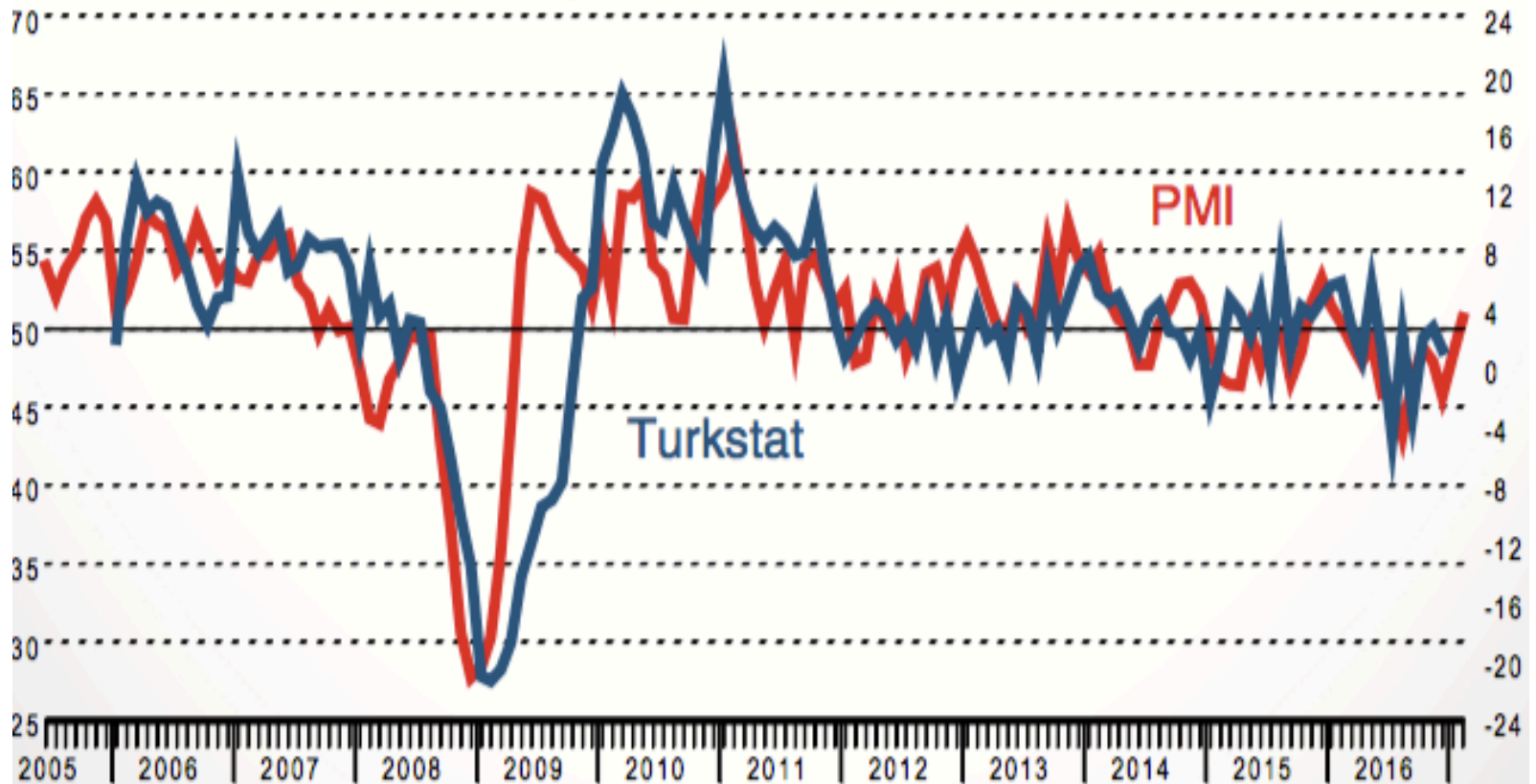


Despite some recovery, we are in sub-par growth territory...

## Historical overview

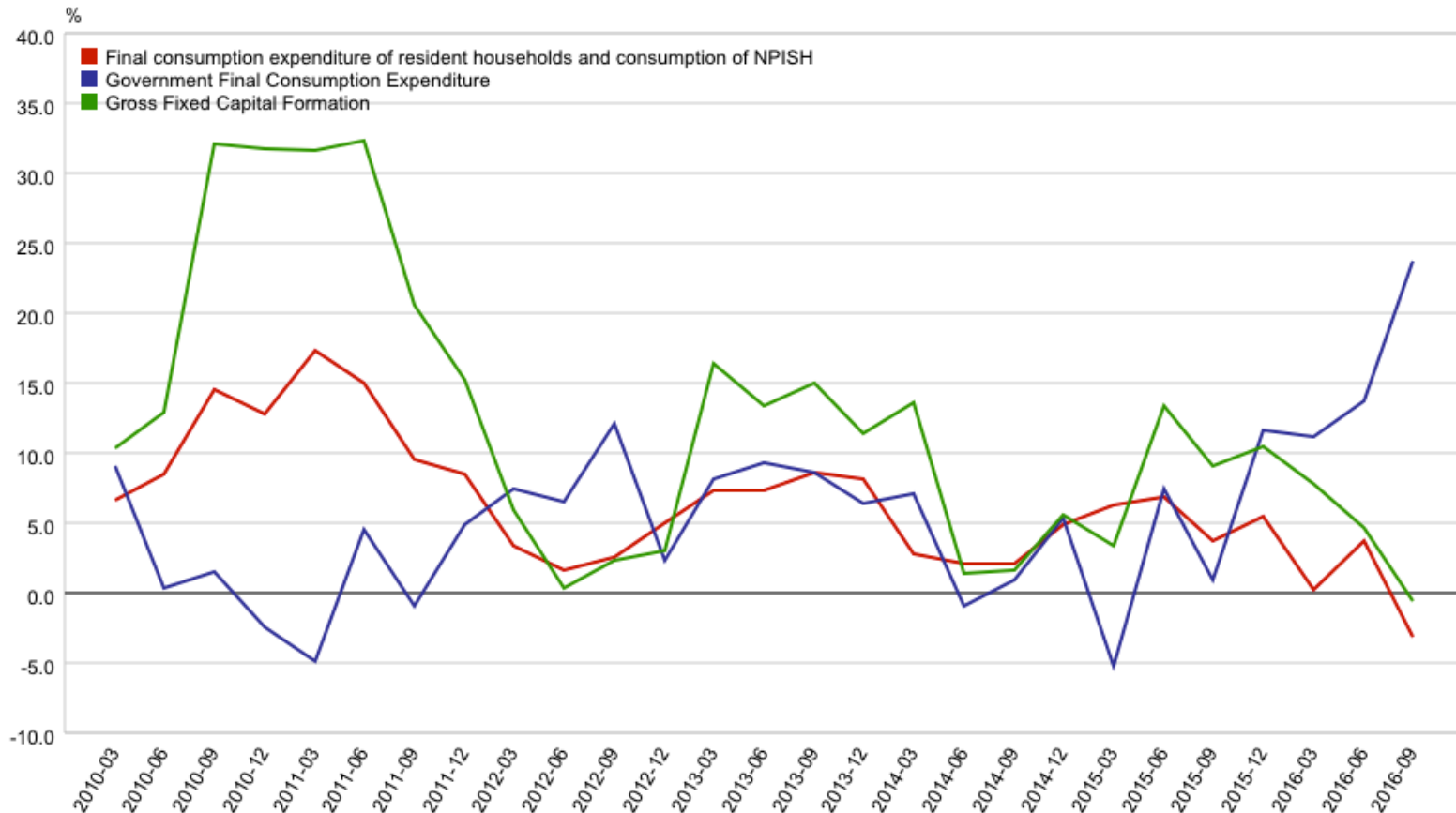
PMI Output Index, 50.0 = no change

industrial production yr/yr%



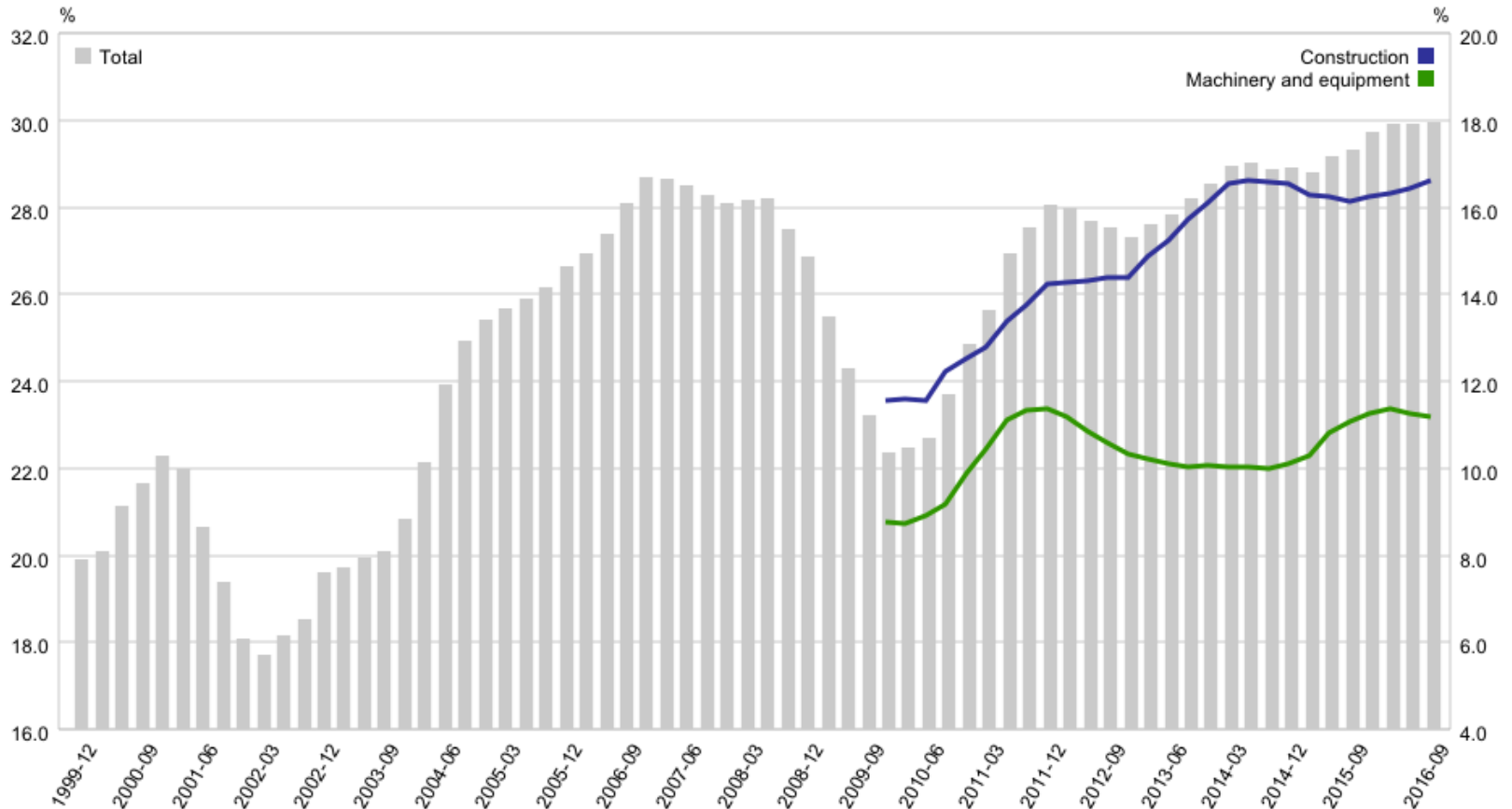
# Growth has largely been driven by private consumption...

## Consumption and Investment Growth (%)



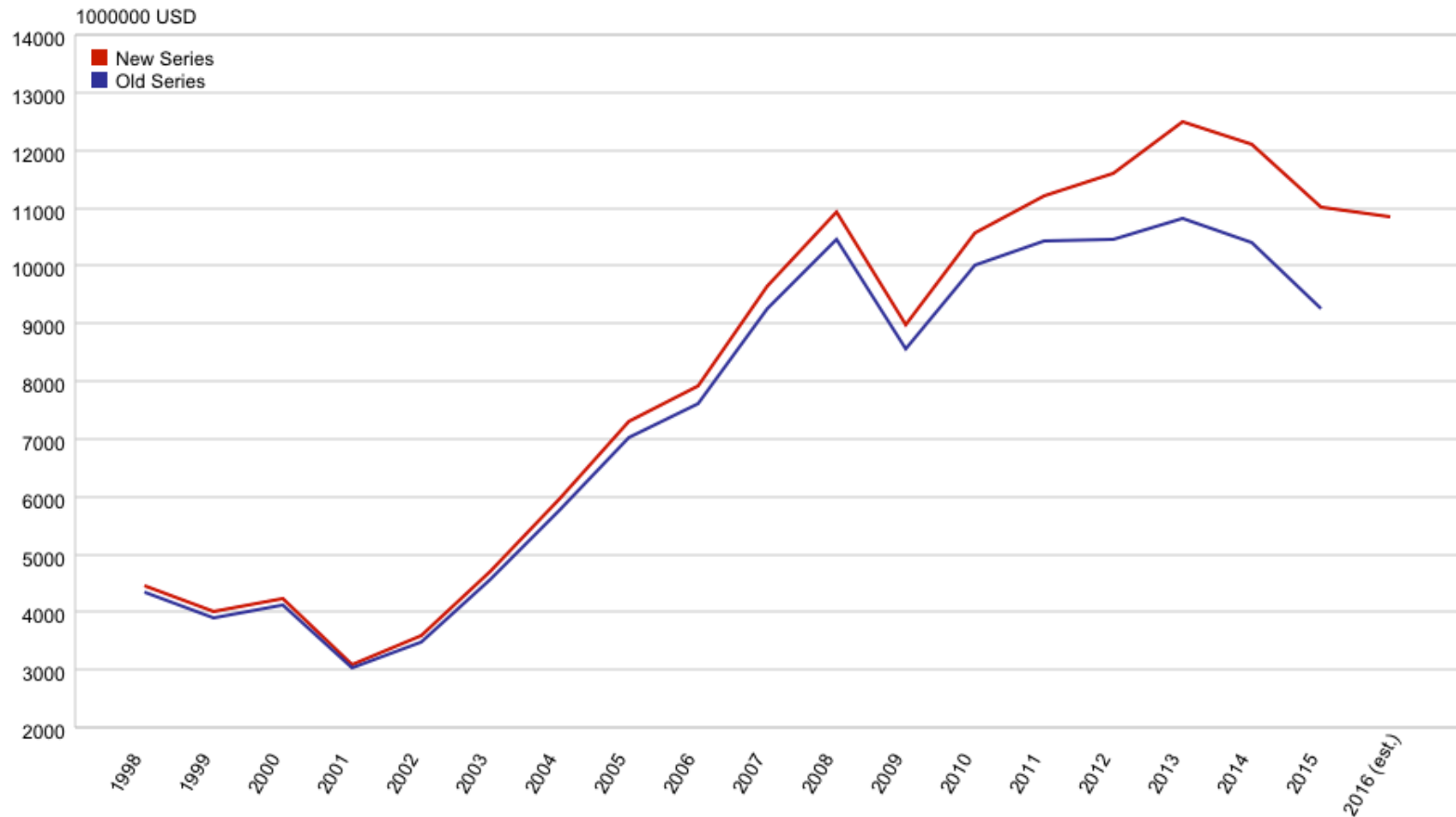
# And investment, largely by construction...

Gross Fixed Capital Formation (% of GDP, 4 quarter rolling)



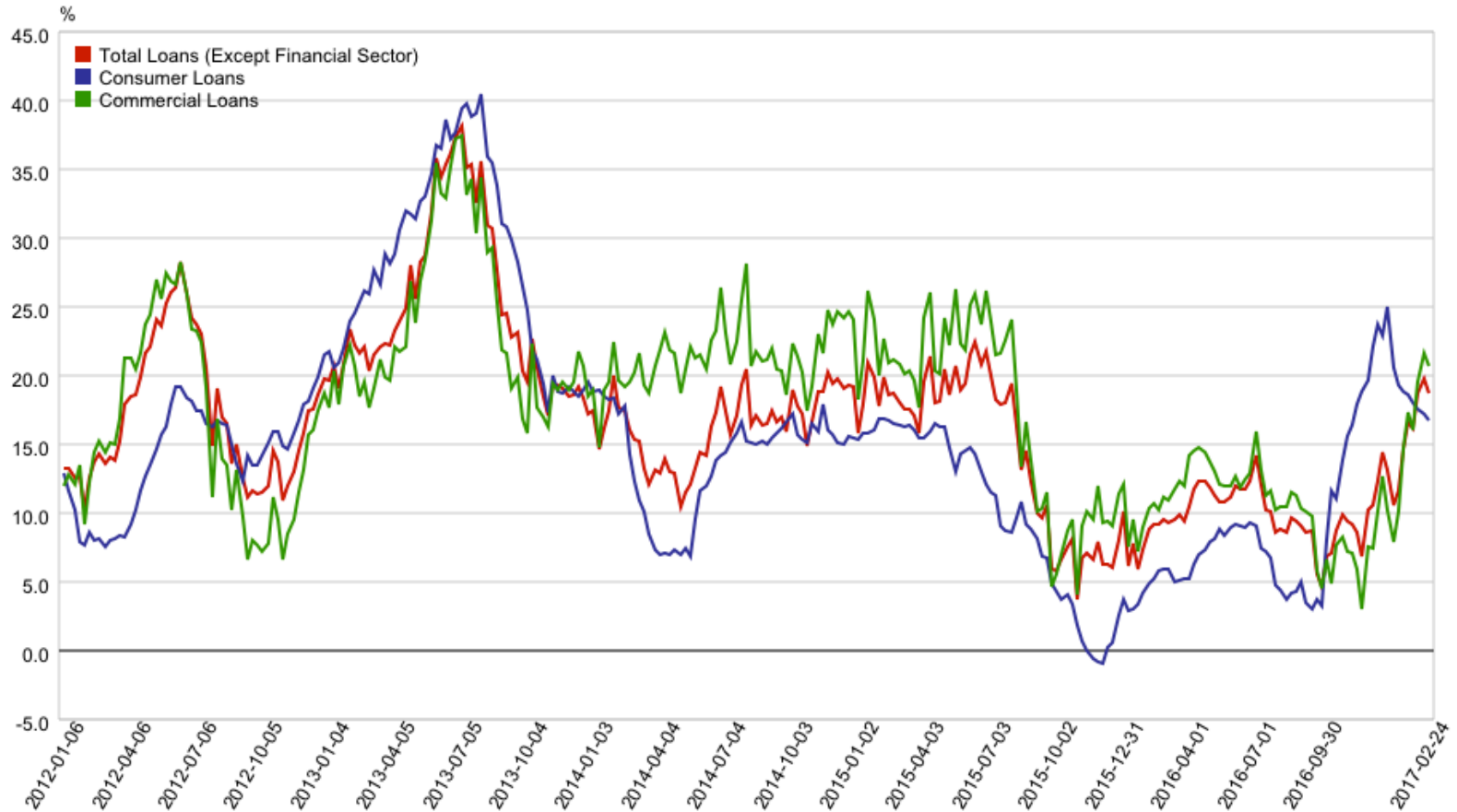
# Despite the GDP revisions, we are not getting richer...

Gross Domestic Product Per Capita (market exchange rates)



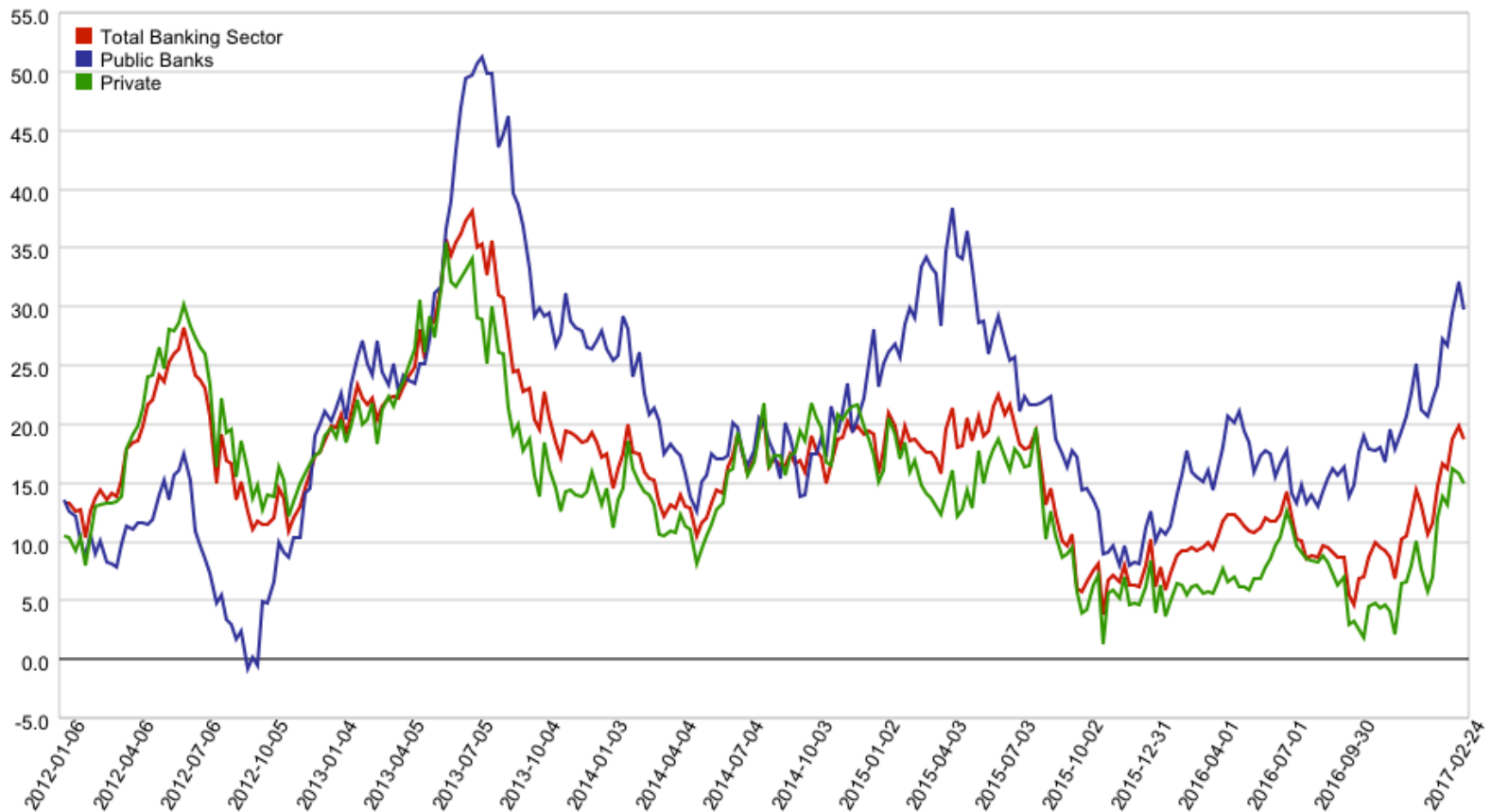
# Credit growth has been accelerating...

Loan Growth: Commercial and Consumer Loans (FX adjusted, 13-week moving average, annualized, %)



# This is largely driven by state banks

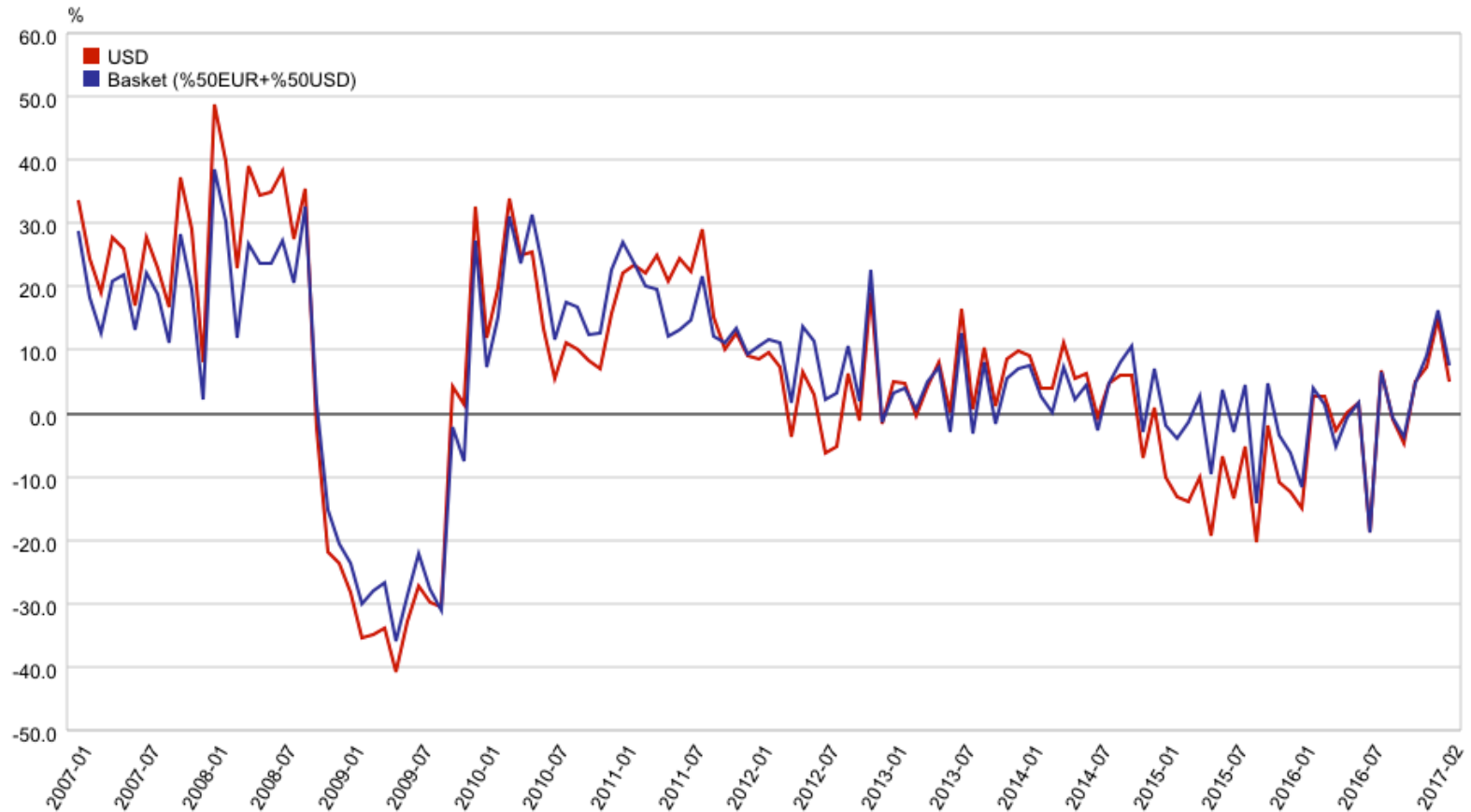
Loan Growth: Private and Public Banks (FX adjusted, 13-week moving average, annualized)





# Exports have picked up but this may not last too long...

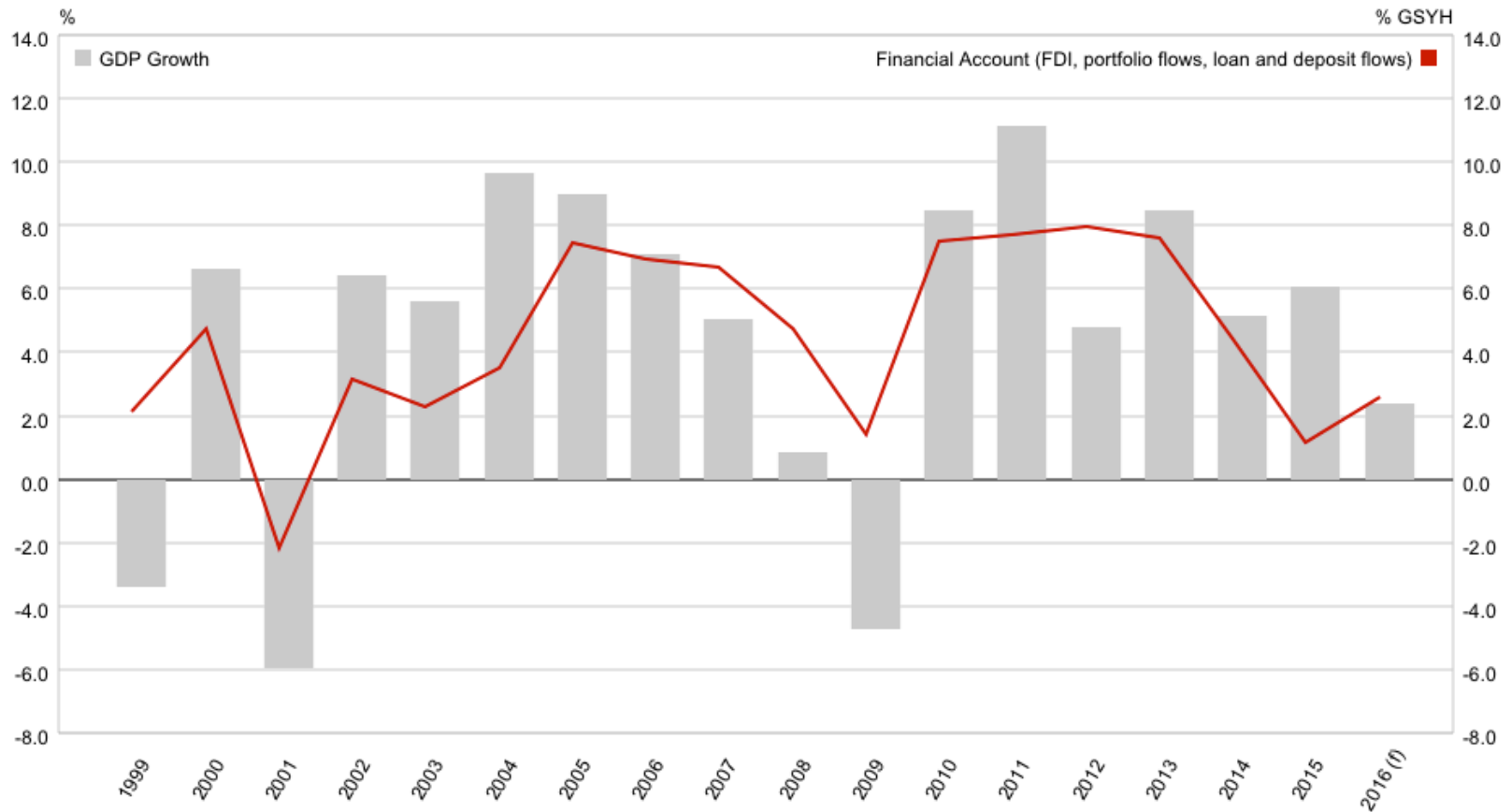
Exports: Preliminary Data from Turkish Exporters' Association (yoy, %)



# Ultimately, growth is about capital flows...

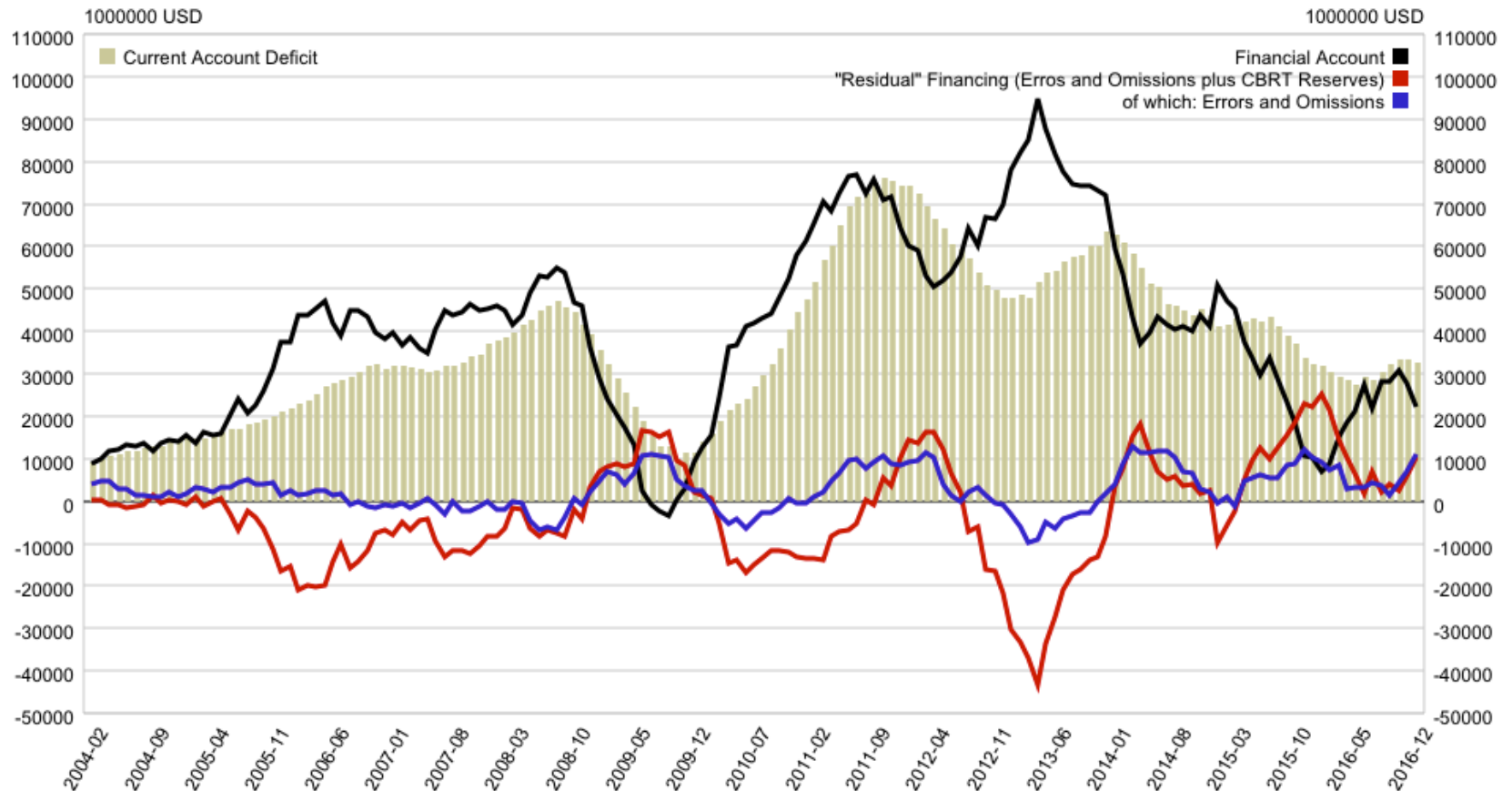
GDP Growth (%) and Capital Flows (% of GDP)

TURKEY DATA MONITOR



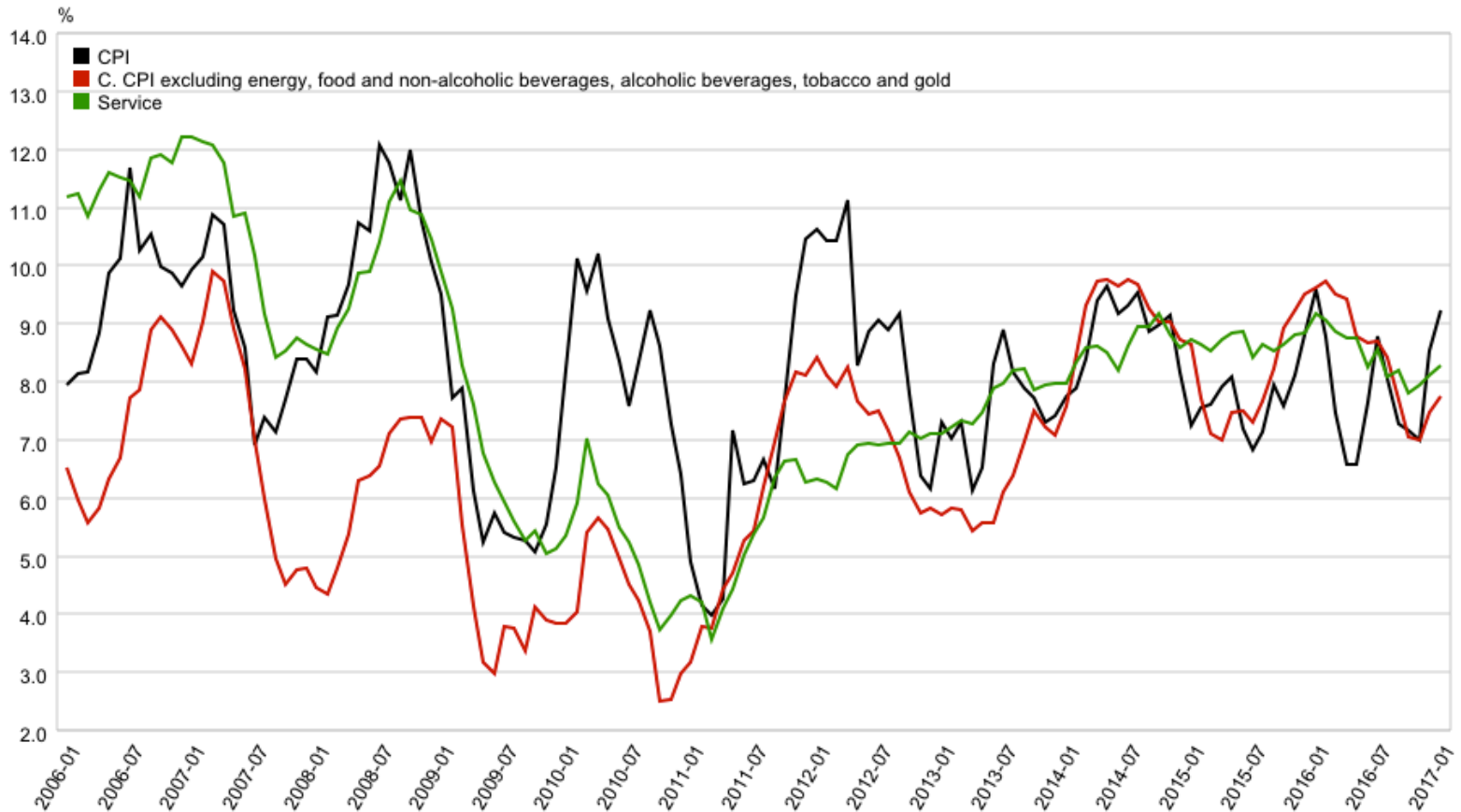
# Lately, we have been counting on “residual” financing...

Current Account vs. Financing Flows (12-month rolling)



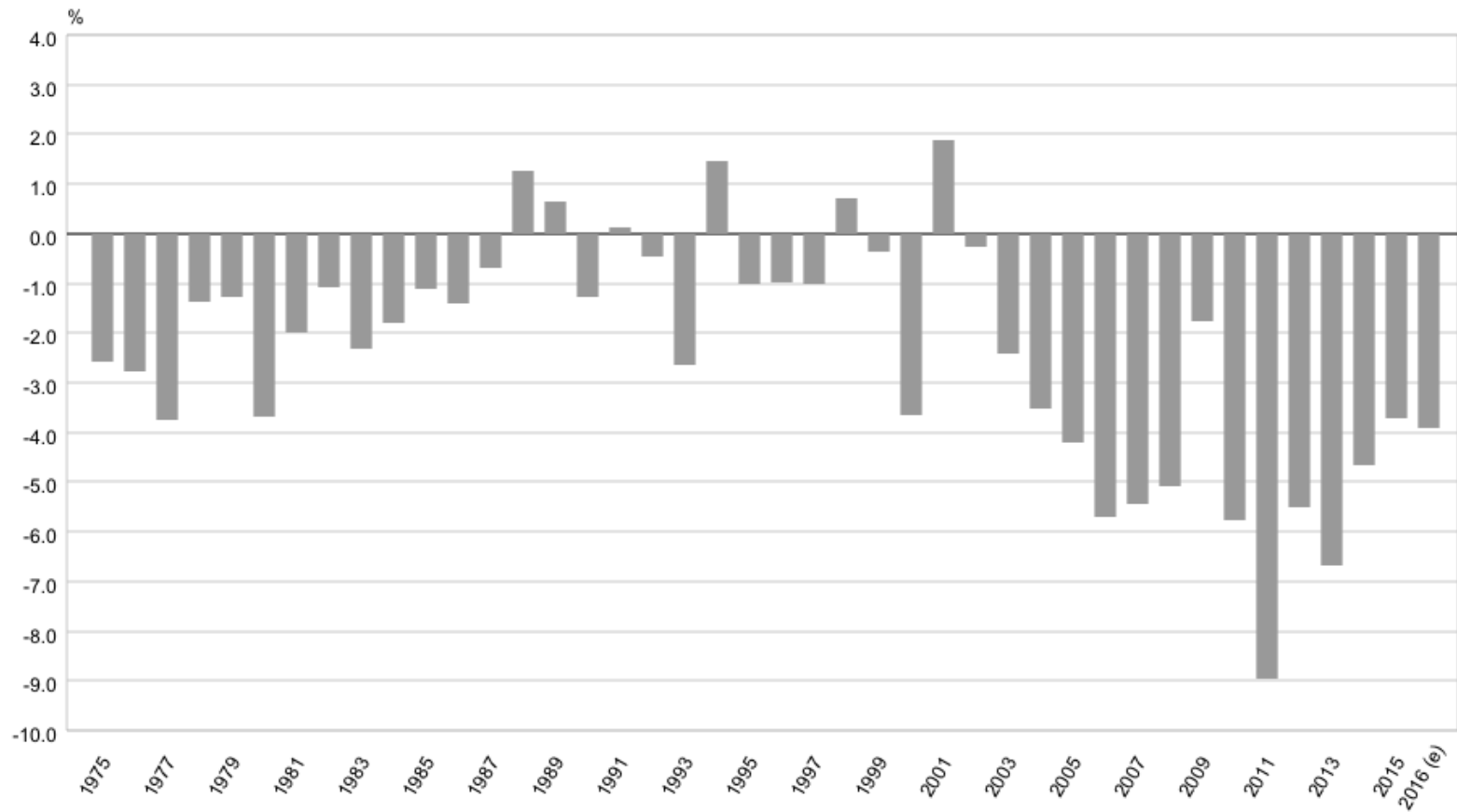
# Inflation is sticky and rising...

CPI, Core and Service Inflation (% , yoy)



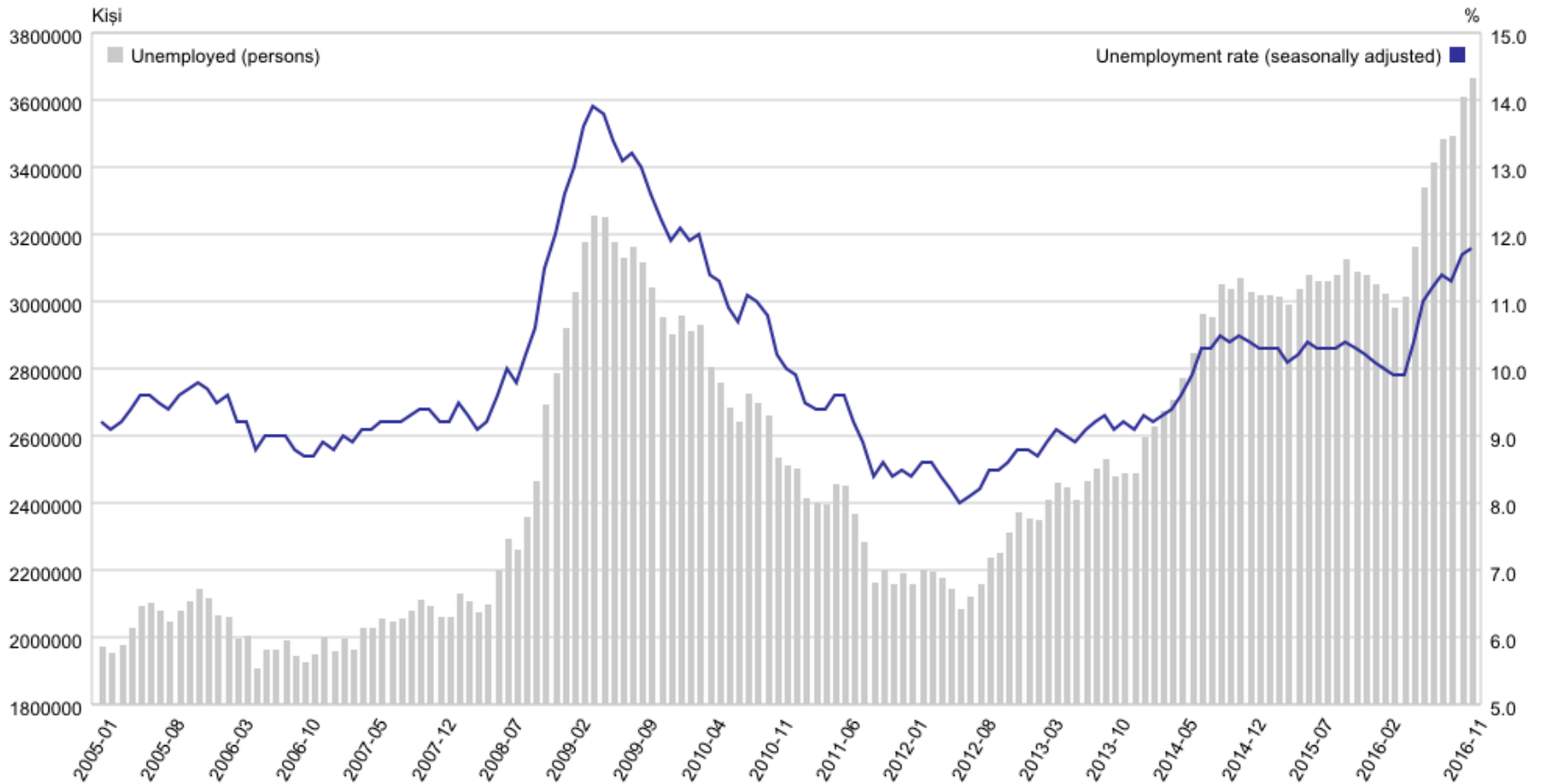
# Current account deficit is stuck around 4% of GDP...

Long View: Current Account Balance (as % of GDP)



# Unemployment is rising...

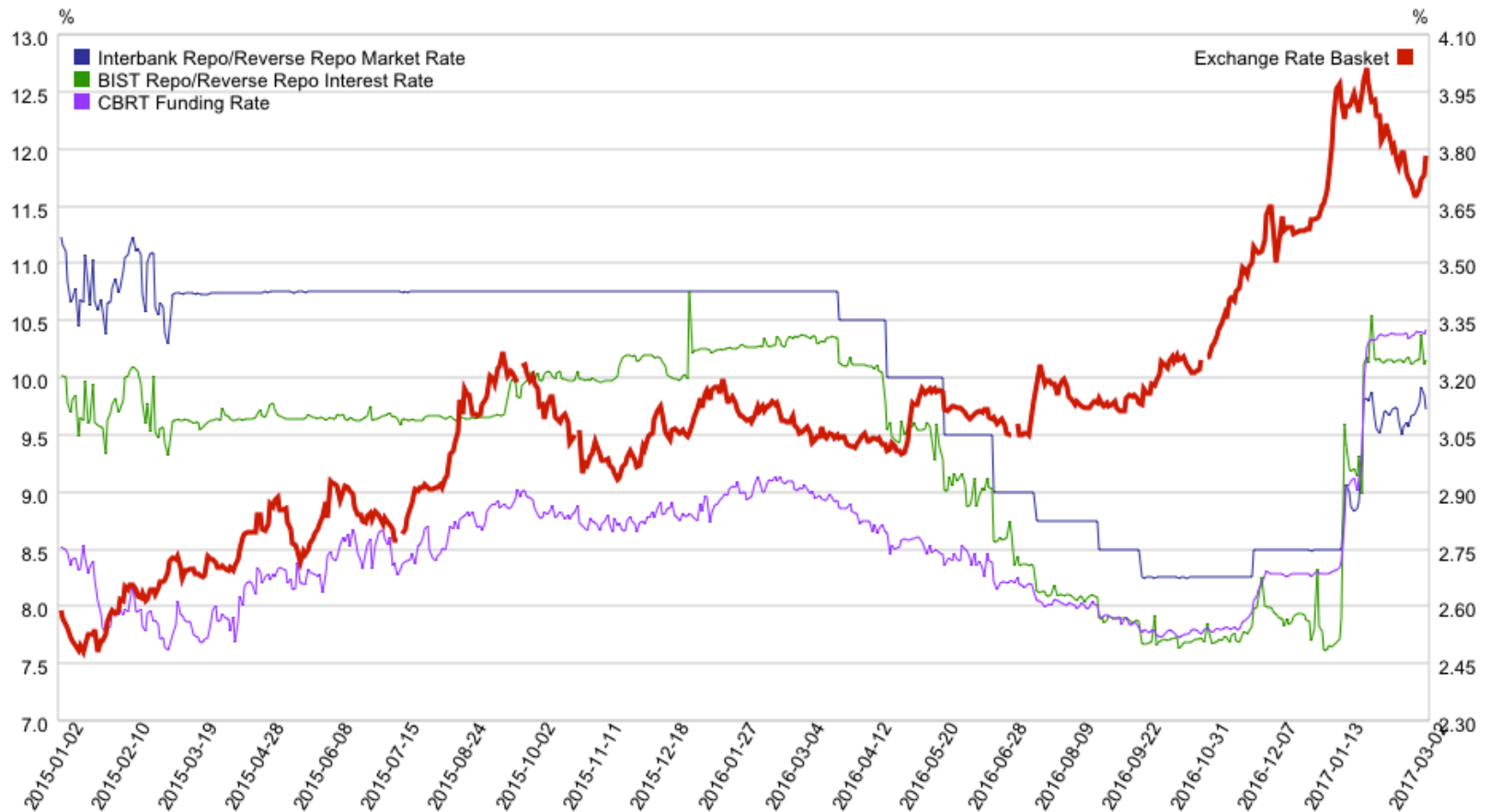
## Unemployment Rate and Unemployed Persons



# Monetary policy is managing, clumsily, growth vs. the lira...

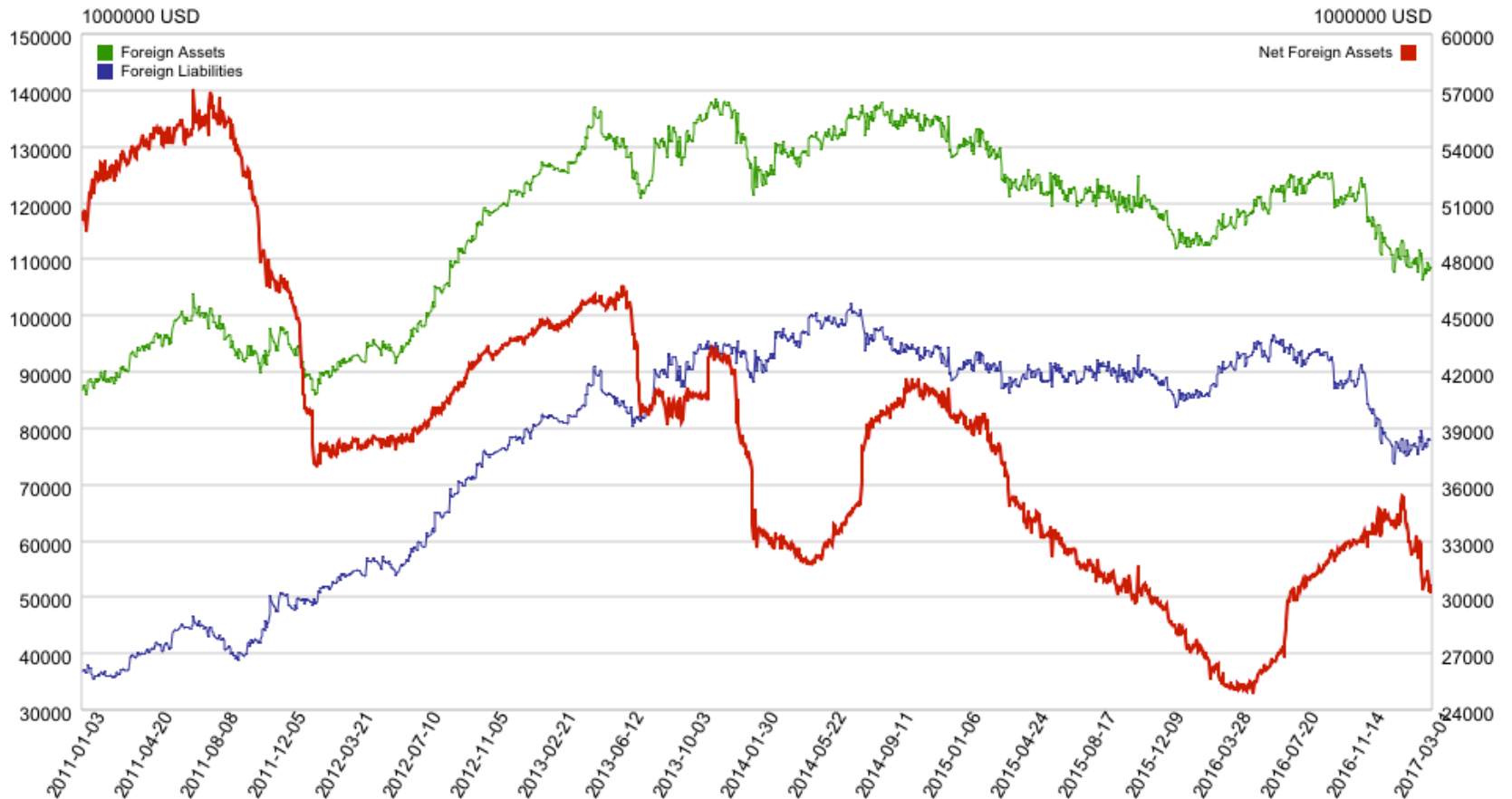
## Nominal Exchange Rate and Money Market Rates

TURKEY DATA MONITOR



# We have been drawing down our reserves a bit lately...

CBRT Net Foreign Assets (million USD)





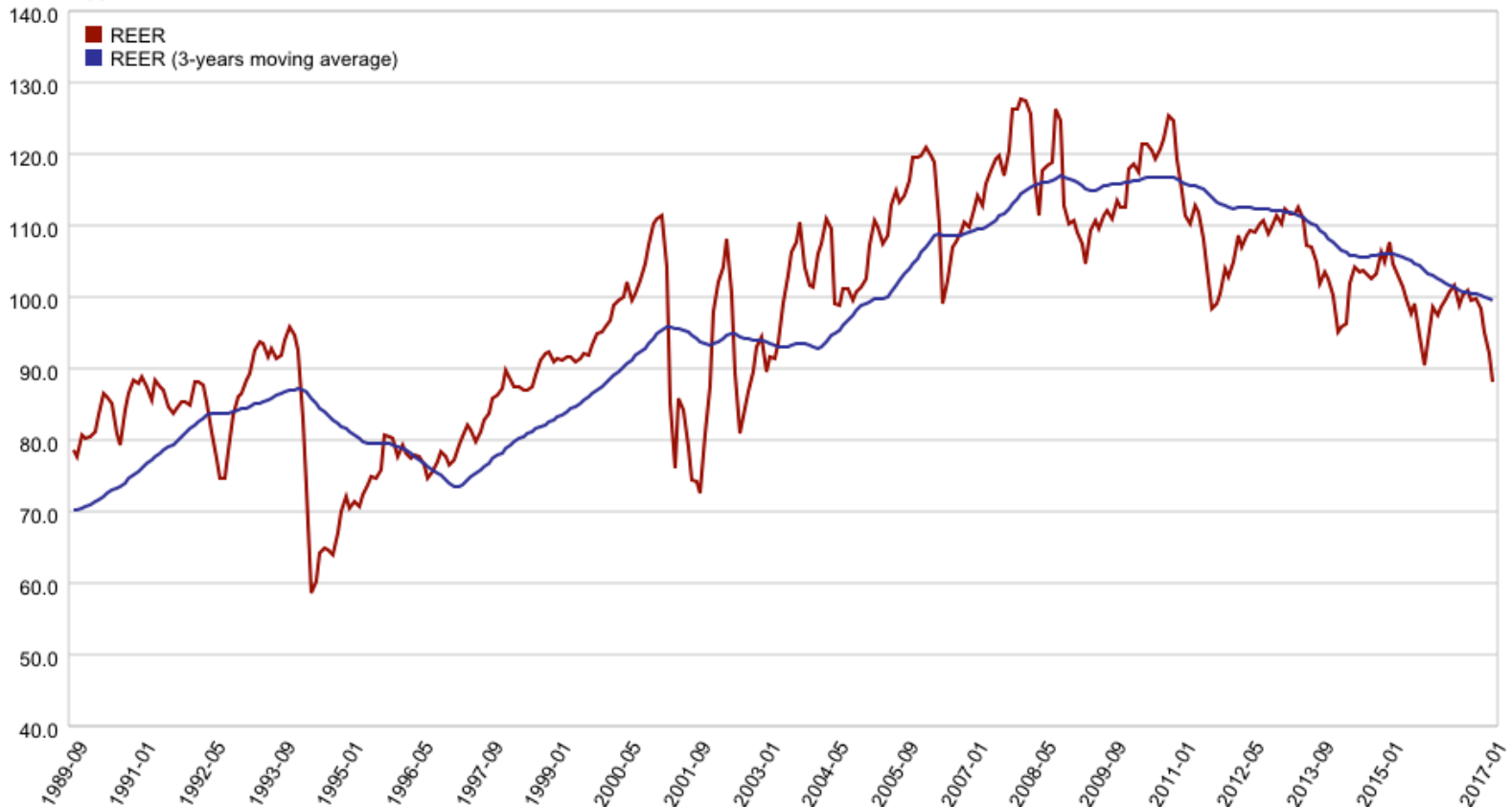
# Lira seems undervalued by some metrics, but...

## Long View: Real Effective Exchange Rate



(2003=100)

(\*Series has been extended backward by using percentage changes from the old series)  
Index



# Wage growth is running much faster than inflation...

Growth in Hourly Earnings Indices vs. CPI Inflation (% , yoy)

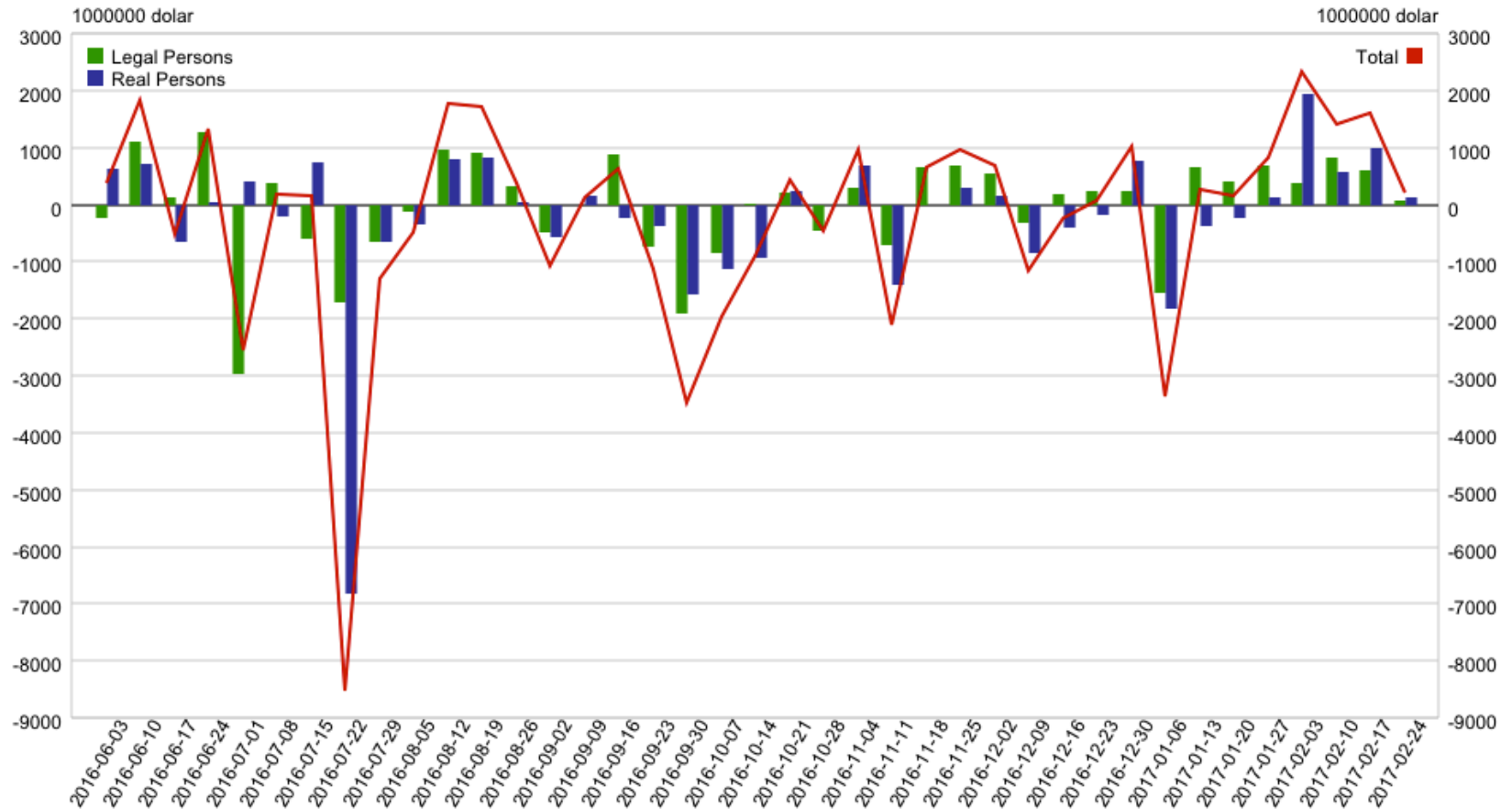


# Residents have been turning back to F/X deposits...

## Banking System Foreign Exchange Deposits (change over a week ago)

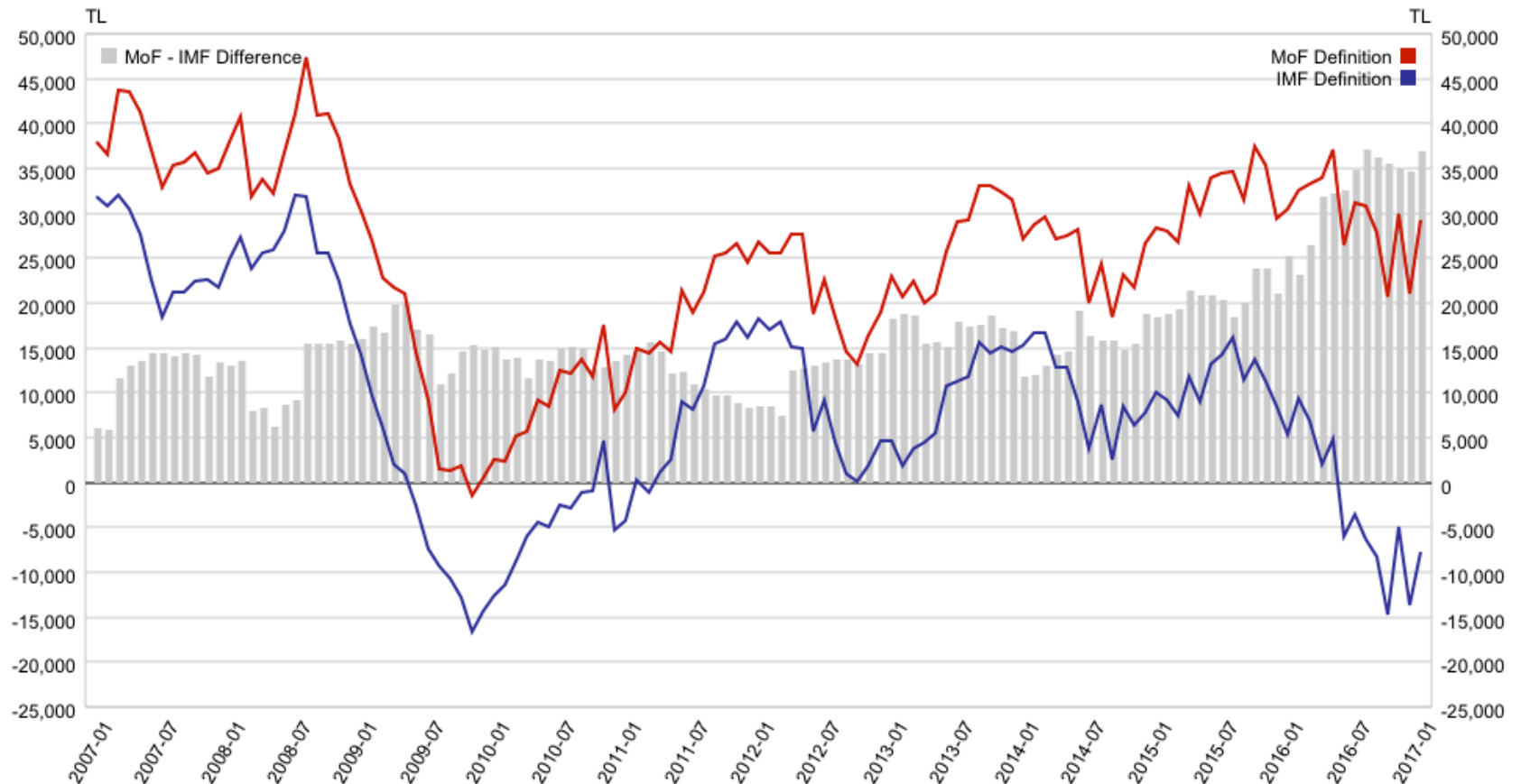


\*unadjusted for valuation



# Fiscal policy is holding up – for now...

Central Government Primary Balance (million TL, 12-month rolling)



## Peeking into the future: Some basic notes/questions...

- Global environment/monetary policy is no longer as supportive...
- On our side, politics is key: how will it play out post-referendum? How probable is the revival of peace process? How will things shape up in the region? Can trust and institutions be restored relatively quickly? Will the security/terror risk decline visibly?
- What is the “economic model”, post-referendum? Back to “orthodoxy” (a rules-based policy environment) or more “heterodoxy” (increased government discretion/intervention)...
- How financeable is the latter model, given our high external financing requirement, lack of natural resources and being a relatively industrialized, globally-integrated and upper middle-income economy?
- How do we break the low growth/high vulnerability nexus? Studies show Turkish potential growth around 3%, which could rise to 4.5%+ with “reforms” (of institutions, labor market, lower inflation, etc.)...
- Turkey has the familiar strengths (e.g., demography, dynamism, fiscal space, well-capitalized banks, smooth access to capital)...
- What will all this add up to going forward?

## Qualitative Scenarios for 2017 (and Beyond?)

- Baseline (=muddle-through) scenario: Growth fares weak (around 2%-3%), as both inflation (8%-9%) and the CAD/GDP (4%+) stay high...
- Additional scenarios may be conceived, depending on the referendum outcome, the global environment and the policy response – and how they interact...
- A “good” scenario would have post-referendum visibility/ sentiment improve, social as well as regional tensions ease, helping Turkey achieve a faster growth rate...
- The bad (or ugly) scenario(s) would mean “things may have to get worse before they get better”...
- How worse? Again, politics and the CBRT response to possible market pressures will be the key...

**Macro Framework: 2013-17**

	2013	2014	2015	2016e	2017f
Growth (GDP; %)	8.5	5.2	6.1	2.2	2.5
GDP (TL; bn.)	1,810	2,044	2,338	2,540	2,877
GDP (\$; bn.)	950	934	858	840	775
GDP per capita (\$; mkt. rate)	12,477	12,096	10,974	10,622	9,700
CPI Inflation (%)					
Avg.	7.5	8.9	7.7	7.8	10.5
EoP	7.4	8.2	8.8	8.5	9.3
Central Government Budget (TL bn; MoF def)	-1.5	-5.4	-23.5	-29.3	-56.9
as % of GDP	-0.1	-0.3	-1.0	-1.2	-2.0
o/w: Primary Balance (as % of GDP; MoF def)	0.7	0.6	1.3	0.8	0.0
Central Government Debt (as % of GDP)	32.4	29.9	29.0	29.9	29.5
Domestic	22.3	20.3	18.8	18.5	...
External	10.1	9.7	10.2	11.5	...
Current Account Balance (\$ bn)	-63.6	-43.6	-32.3	-33.2	-36.0
as % of GDP	-6.7	-4.7	-3.8	-4.0	-4.6
Trade Balance (TURKSTAT definition; \$ bn)	-99.9	-84.6	-63.4	-56.0	-62.3
External Debt (\$ bn)	390	402	398	415	432.0
as % of GDP	41.1	43.1	46.3	49.4	55.7
Exchange Rate (TL/\$)					
Avg.	1.91	2.19	2.72	3.02	3.71
EoP (Dec. average)	2.06	2.29	2.92	3.50	3.92
%	15.8	11.1	27.3	19.7	12.2
Real Effective Exchange Rate (2003=100)					
EoP (Dec. average)	100.3	105.0	97.5	92.2	88.2
% ('+' means appreciation)	-9.1	4.7	-7.1	-5.5	-4.3
Interest Rate (benchmark, compounded; %)					
EoP (Dec. average)	9.4	8.1	10.9	10.8	12.0
Benchmark Real Rate (eop; ex-post %)	1.9	-0.1	1.9	2.1	2.5
Interbank Rates (eop; avg. 5 b-days; simple, %)	7.75	11.09	10.75	8.50	10.5
Memo Items:					
Oil Price (Brent, p/b, avg.)	108.7	99.0	52.4	43.5	56.4
Euro/USD (eop)	1.37	1.23	1.09	1.06	1.05

Source: CBT, MoF, Treasury, TURKSTAT, our calculations and projections.

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