Economics
12 February 2015

MonitorING Turkey

Deeper easing?

Continued lower oil prices mean that the improvement in the external deficit is expected to accelerate in coming months, from c. 5.7% of GDP at end-2014 to 4.4% in 2015. The CBT cut its end-2015 inflation call to 5.5% (consensus: 6.8%) in January's expectation survey. 12M and 24M forecasts both fell to end-2013 levels in the survey, with significant improvements to 6.8% and 6.4%, respectively. The latest indicators suggest a benign inflation outlook.

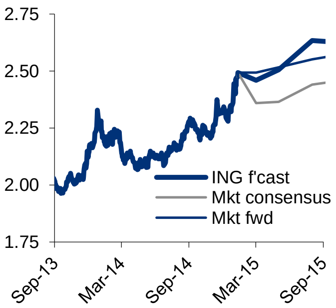
- We believe the improvement in headline inflation should continue, with a fall in the annual figure, from 7.24% in January towards 5-5.5% by the end of 2Q15, supporting our expectation of a better outlook. Given weakening inflationary forces and improving inflation expectations, the CBT has become more confident and has signalled potential deeper easing at the end of January. On the back of the CBT's further monetary accommodation and commitment to keep the ex-post real policy rate slightly positive, we expect the policy rate to be 6.5% in 1H15. However, given a worsening global risk appetite and significant TRY weakness, upside risk to our call has increased in recent days.
- The ongoing uncertainty about the normalisation of global monetary policies is a major source of the volatility in risk appetite and capital flows. In this environment, the TRY remains quite sensitive to global market swings and more-than-initially-expected easing adds pressure on the currency, as seen in market movements in recent days that pushed USD/TRY close to 2.50. We revise our year-end call from 2.45 to 2.60.
- The main focus over the month ahead will be the February MPC, where we envisage a 50bp cut in the policy rate. However, we expect the CBT to continue to keep the upper band of the rate corridor (O/N lending rate) reasonably high, with only a 25bp cut to maintain flexibility when the TRY comes under pressure.

Quarterly forecasts

	3Q14	4Q14	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F
Real GDP (%YoY)	1.7	3.1	4.5	3.9	3.7	3.8	3.5	3.9
CPI (%YoY) eop	8.9	8.2	6.7	5.4	6.0	6.5	6.2	6.3
Policy interest rate (%) eop	8.25	8.25	6.75	6.50	6.50	6.50	6.50	6.50
3-month interest rate (%) eop	10.95	10.02	7.95	8.12	7.78	7.24	6.95	6.89
10-year yield (%) eop	9.95	8.02	7.17	8.02	7.81	7.53	7.35	7.33
Exchange rate (USD/TRY) eop	2.28	2.33	2.46	2.55	2.65	2.60	2.63	2.65
Exchange rate (EUR/TRY) eop	2.88	2.82	2.71	2.68	2.73	2.60	2.56	2.52

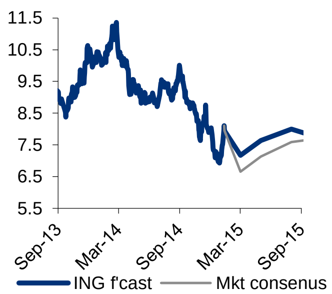
Source: EcoWin, ING estimates

USDTRY



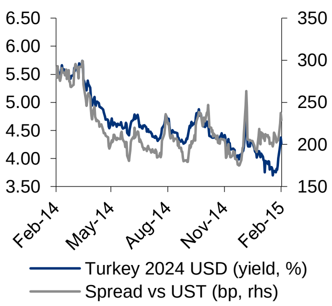
Source: EcoWin, ING estimates

Local 10Y yields (%)



Source: EcoWin, ING estimates

US$ Eurobond 10Y



Source: Bloomberg

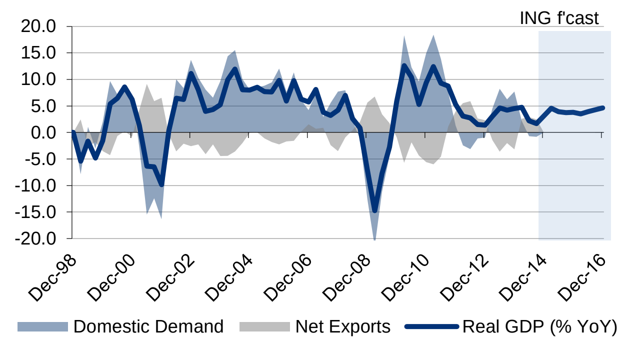
Latest indicator surprises

Output	Positive
Consumption	Positive
Inflation	Higher
External	Negative
Budget	Neutral

Source: Bloomberg

Muhammet Mercan
Chief Economist, Turkey
Istanbul +90 212 329 0751
muhammet.mercan@ingbank.com.tr

Fig 1 Real GDP (%YoY) and contributions (ppt)

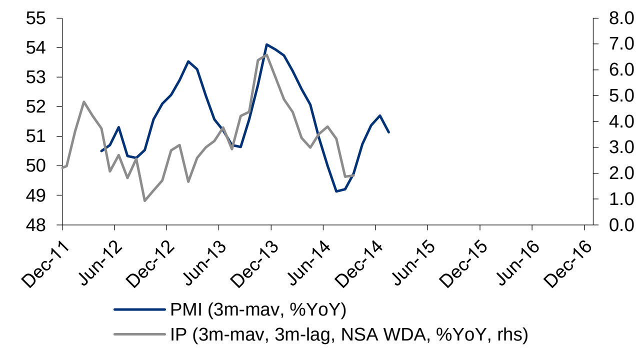


Source: EcoWin, ING estimates

Growth forecast to improve in 2015

- Following a strong start to 2014 with 4.8% growth in 1Q, economic activity remained sluggish thereafter, recording a mere 1.7% YoY in 3Q14, attributable to a large drawdown in inventories.
- A downside surprise in recent IP prints, as well as weak consumer and business confidence suggest modest growth in 4Q14. We expect 3.0% in 2014 with downside risks to the momentum.
- Given the downtrend in oil prices and easier monetary conditions, we expect 2015 growth to improve to 4%. Macro prudential policies of the BRSA that limit household borrowing, along with reflections of the Fed policy normalisation, with a possible impact on capital flows, should cap the growth performance.

Fig 2 IP vs PMI

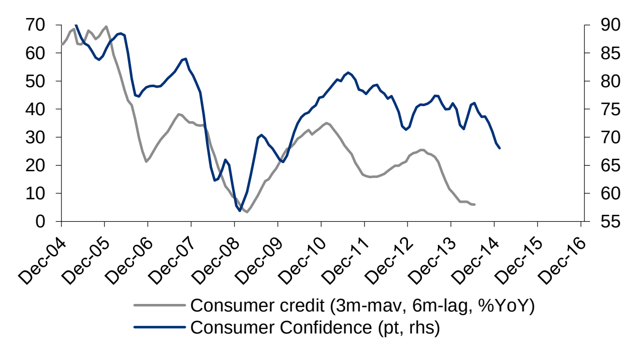


Source: EcoWin, ING estimates

Strong December IP

- Following weak IP in the first two months of 4Q, it recorded strong 2.65% YoY growth (calendar-adjusted basis) in December and turned out to be slightly higher than consensus.
- PMI improved gradually from 48.5 in July to November's nine-month high of 52.2, but reversed gains in the last two months, with a further drop to 49.8 in January. A level below the 50 threshold, signalling economic contraction, is relatively broad-based and is attributable to tightening financial conditions in 4Q with the CBT keeping money market rates elevated.
- Weakness in January PMI should be temporary, as the ongoing easing cycle should support economic activity going forward.

Fig 3 Consumer confidence vs credit

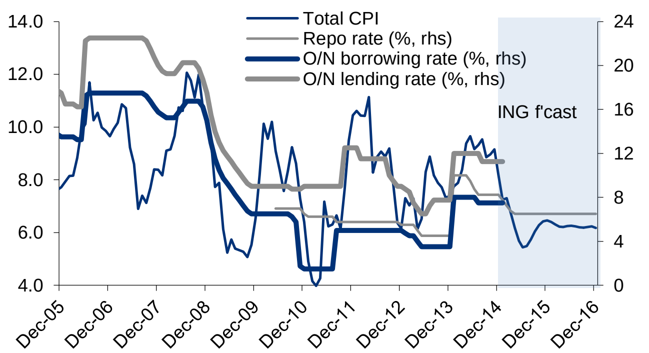


Source: EcoWin, ING estimates

Asset quality to remain intact

- Consumer confidence, which deteriorated in 4Q14, remained weak in January at 67.7, its lowest level in the last three years. A significant decrease in the probability of borrowing on the back of the easing cycle and the assessment of the general economic situation, probably due to the weaker TRY, draw attention.
- Annual credit expansion stood at 16.3% at end-Jan, close to the CBT's 15% reference rate, with a relatively higher increase in company loans. Going forward, volume growth should remain healthy on the back of a more dovish CBT than expected and an improving growth outlook. As such, the NPL ratio at 2.8% (according to the latest data) is expected to be resilient in 2015.

Fig 4 CPI vs policy rate

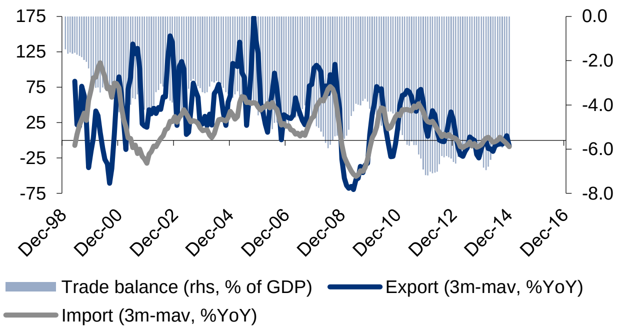


Source: EcoWin, ING estimates

Less-than-expected drop in annual CPI

- CPI increased 1.10% last month, well above market consensus of 0.7% (and our 0.65% call), mainly due to food prices and the alcoholic beverages & tobacco group.
- However, given the large base effects from last year, annual inflation dropped to 7.24% from 8.17% in December. However, the improvement remained lower than the 1ppt forecast by the CBT, which will convene an early MPC in February.
- Eight out of nine core indicators dropped in January. As a result, annual inflation in H&I groups fell to 9.36% and 8.63% from 9.55% and 8.73%, respectively, showing a continuation of the improvement in core indicators.

Fig 5 Trade balance (3m)

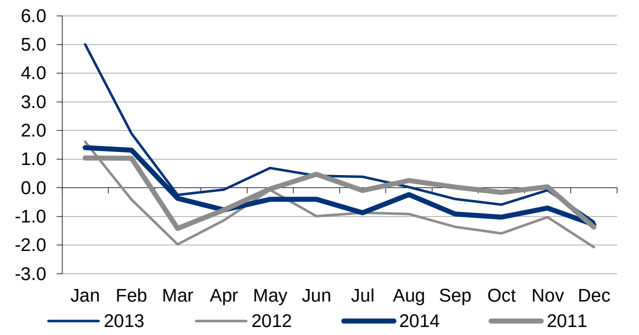


Source: EcoWin, ING estimates

No surprise in December trade balance

- The foreign trade deficit was in line with expectations at USD8.5bn in December, pulling the annual deficit down to USD84.5bn in 2014. Accordingly, the 12M rolling deficit maintained its general improvement trend begun at end-2013. Excluding gold and energy, it remained practically unchanged at USD35.3bn.
- Overall, exports registered resilient growth of 3.9% in 2014, with a stronger performance in 1H14, but losing momentum in 2H14 due to escalating geopolitical tensions that weighed on trade with neighbouring countries and the lacklustre nature of the economic recovery in EU. Imports contracted by 3.7% in 2014 on the back of weak domestic demand and falling oil prices.

Fig 6 Budget performance YTD (% GDP)

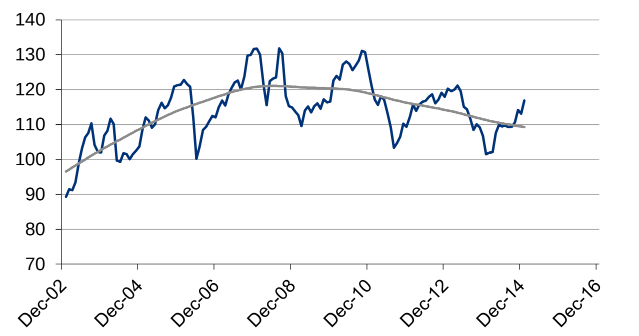


Source: EcoWin, ING estimates

Sound fiscal performance in 2014

- Public finances performed well in 2014 and turned out better than envisaged thanks to one-off revenues from privatisation receipts. Improvement in primary surplus was also eye-catching due to revenue generation and a measured rise in expenditures versus the original yearly targets set at end-2013.
- The government anticipates relatively ambitious fiscal performance from 2014 onwards, with a significant decline in the central administration budget balance to a mere 0.3% in 2017, mainly by controlling the expenditures. However, this will be challenging work given the ongoing election cycle, which will end with general elections in June 2015.

Fig 7 FX: REER vs trend (index)



Source: EcoWin, ING estimates

TRY reached its all-time high against the USD

- TRY adopted a real appreciation trend in 2014, with REER increasing from 101.5 in Jan-14 (the lowest level since Jun-06) to 116.9 in Jan-15, above the long-term average. This increase was not only because of the CBT's sharp tightening at the beginning of 2014, but also due to elevated inflation close to double-digit levels.
- Although the CBT acted cautiously in the last MPC with a measured cut, political pressure to ease deeper and faster has resulted in signals from the bank of somewhat aggressive rate cut(s) in the coming period, which weighs on the currency.
- A less favourable capital flow outlook with the US monetary policy normalisation is also a concern for the TRY's performance in 2015.

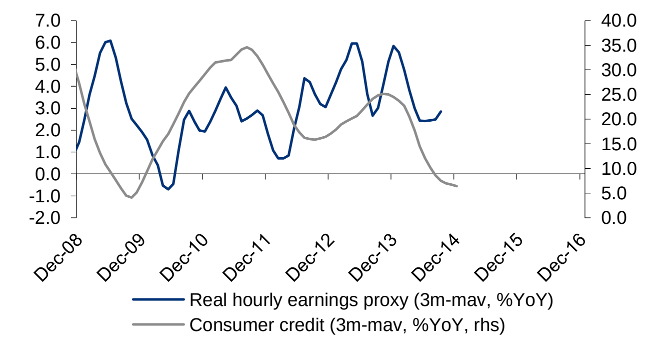
Fig 8 Main macroeconomic recent releases

	Previous-2		Previous-1		Actual		Surprise	Consensus
Capacity utilisation (%)	Nov	74.5	Dec	74.6	Jan	73.7		-
Industrial confidence	Nov	102.7	Dec	101.2	Jan	103.2		-
Industrial production (SA WDA, MoM%)	Oct	-2.3	Nov	0.5	Dec	1.2	+	0.7
Industrial production (WDA, YoY%)	Oct	2.4	Nov	0.7	Dec	2.7	+	1.9
Turkey consumer confidence	Nov	68.7	Dec	67.7	Jan	67.7		-
Unemployment rate (%)	Aug	10.1	Sep	10.5	Oct	10.4	-	10.8
GDP (SA WDA, QoQ%)	Q1	1.8	Q2	-0.5	Q3	0.4	+	0.4
GDP (YoY%)	Q1	4.8	Q2	2.2	Q3	1.7	-	2.8
GDP (WDA, YoY%)	Q1	4.8	Q2	2.5	Q3	1.8	-	2.8
Turkey core CPI (YoY%)	Nov	9.0	Dec	8.7	Jan	8.6	+	8.1
CPI (YoY%)	Nov	9.2	Dec	8.2	Jan	7.2	+	6.8
PPI (YoY%)	Oct	6.8	Nov	5.7	Dec	7.0		-
1W repo rate announcement (%)	Nov	8.25	Dec	8.25	Jan	7.75	-	8.25
Overnight borrowing rate announcement (%)	Nov	7.50	Dec	7.50	Jan	7.50		7.50
Overnight lending rate announcement (%)	Nov	11.25	Dec	11.25	Jan	11.25		11.25
Trade balance ($bn)	Oct	-6.3	Nov	-8.3	Dec	-8.5	-	-8.5
Current account ($bn)	Oct	-2.3	Nov	-5.7	Dec	-6.8	-	-6.8

Source: Bloomberg

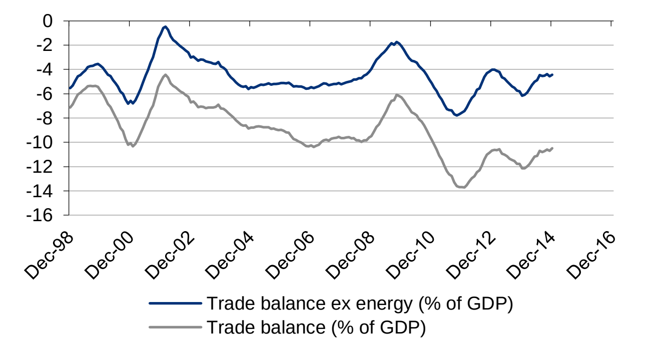
Additional charts

Fig 9 Wages and credit



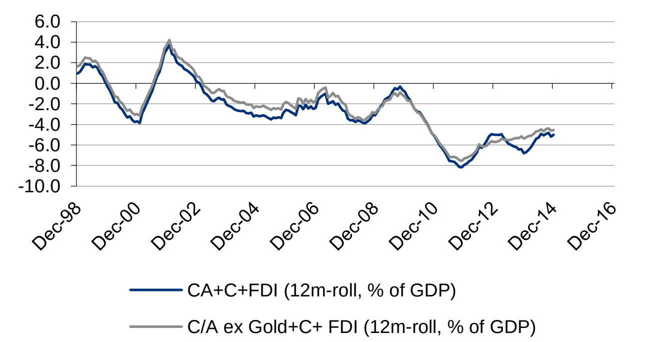
Source: EcoWin, ING estimates

Fig 10 Trade balance (annual)



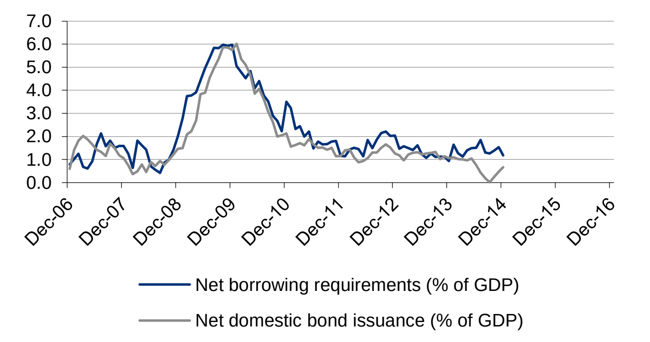
Source: EcoWin, ING estimates

Fig 11 C/A, CA and FDI



Source: EcoWin, ING estimates

Fig 12 Gvt' central borrowing requirements (annual)



Source: EcoWin, ING estimates

ING Bank A.Ş. Economic Research Group

Muhammet Mercan Chief Economist + 90 212 329 0751 muhammet.mercan@ingbank.com.tr

DISCLAIMER:

Investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided in accordance with a contract of engagement on investment advisory concluded between brokerage houses, portfolio management companies, non-deposit banks and clients. Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely to this information stated here may not bring about outcomes that fit your expectations.

This report has been prepared by ING Bank A.Ş. Economic Research Group solely for the information purposes of its readers. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, ING Bank A.Ş. makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Neither ING Bank A.Ş. nor any of its officers or employees accepts any liability for any direct or consequential loss arising from any use of this report or its contents.

ING Bank A.Ş. is responsible for the distribution of this report in Turkey.