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BBVA Research

Turkey Economic Outlook

November 2018

Creating Opportunities

Challenging times ahead needing policy determination

01

Turkish financial assets stabilize after reaching lows in summer

A firmer policy response and easing relations with US facilitate the stabilization of Turkish Lira and risk premium

02

Rebalancing is underway and will accelerate from now onwards

The level and the duration of adjustment is still uncertain but will accelerate soon on the tightening credit conditions

03

Inflation will transitorily increase in 1Q19

The exchange rate pass-thru and likely reversal of recent campaigns will keep inflation high in the short term. It should start to stabilize afterwards

04

Monetary policy stays on hold but will remain tight

Higher inflation should prevent the CBRT from easing in the short term. Movements could be more aggressive in the 2nd half of 2019

05

Fiscal consolidation in a realistic New Economic Program

Fiscal policy is already tightening and the targets of 2018 will likely be met. The real challenge will become the next year

06

Restructuring options already under discussions

The Government has started the evaluation period to implement a restructuring process to cope with corporate-bank problems

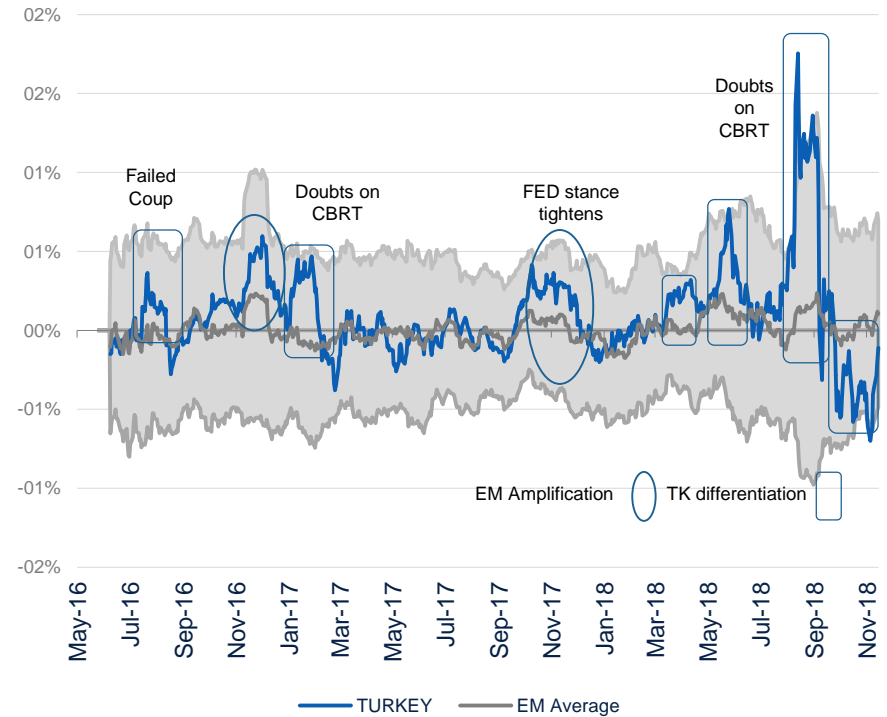
The Turkish Lira and Turkish financial assets continue to improve on a more benign EM outlook, policy changes and geopolitical ease...

Turkish Lira vs USD (level)



EM Currencies volatility

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



The financial adjustment is now under control... Now it is time for the real economic adjustment... we still expect 3% GDP growth in 2018

Turkey: Activity Indicators

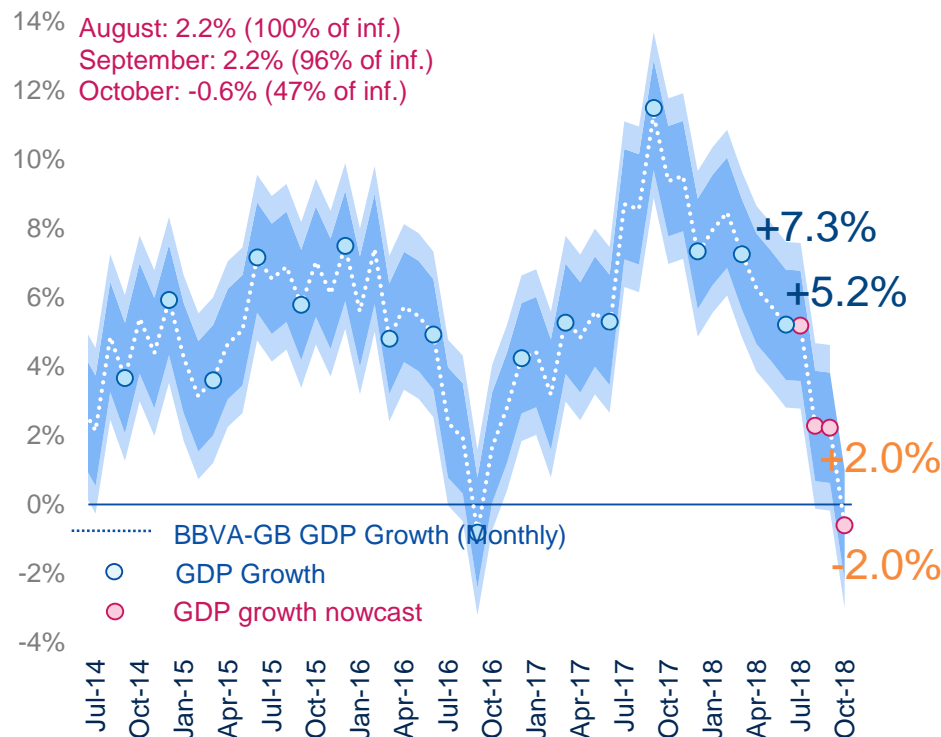
(%YoY, mov. Avg. 3m)

Mean	2018								
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	
Industrial Production	7.8	9.9	7.3	6.4	5.0	6.0	-0.2	0.5	
Non-metal Mineral Production	7.8	16.7	10.3	6.0	3.1	2.8	-4.8	-4.0	
Electricity Production	4.9	3.0	2.4	1.9	0.9	0.9	-0.4	0.2	-12
Auto Sales	6.9	2.2	-0.4	-5.8	-20.0	-29.6	-42.1	-51.5	-66.5
Tourist Arrivals	5.5	34.9	31.2	29.4	28.3	21.0	17.7	14.0	
Number of Employed	3.9	4.4	3.7	3.0	2.5	2.1	1.9		
Number of Unemployed	1.6	-13.5	-10.9	-7.1	-2.3	0.6	4.1		
Auto Imports	8.6	-10	-3.2	-7.4	-21.2	-35.3	-50.9	-59.3	-69.9
Auto Exports	9.2	-3.1	9.6	18.7	37.3	24.3	9.5	5.3	4.8
Retail Sales	6.4	8.9	7.7	6.7	5.8	4.4	1.5		
Manufacturing PMI	51.4	49.6	51.7	49.5	48.4	49.6	46.4	42.7	44.3
Total Loans growth 13-week	19.0	13.1	15.9	17.0	14.5	10.2	1.8	-3.9	-9.1
Real Sector Confidence	106.5	111.9	111.2	109.9	104.6	102.7	96.4	89.6	87.6
MICA Forecast GDP YoY				5.2%			2.2%	-0.6%	

Contraction Slow-down Growth Boom

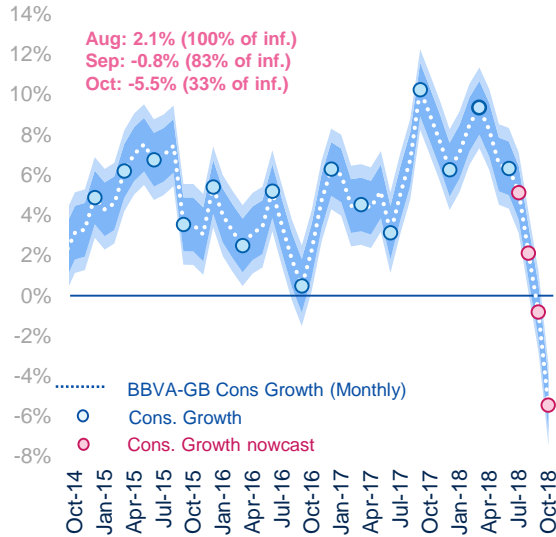
Turkey: GDP Monthly Indicator*

(%YoY mov. Avg. 3m)

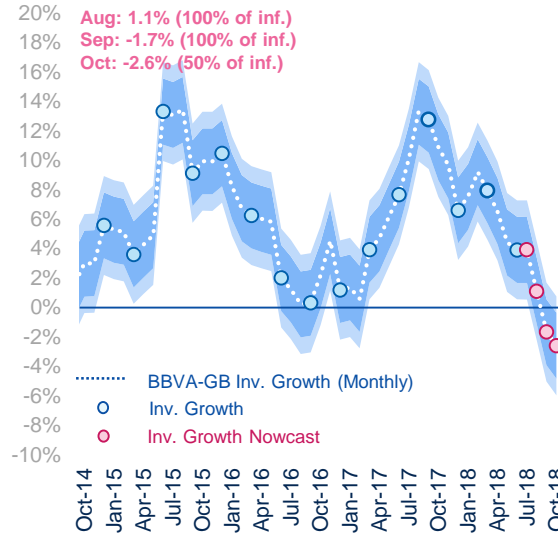


A sharp slowdown in domestic demand is partially buffered by a strong reversal of external demand...

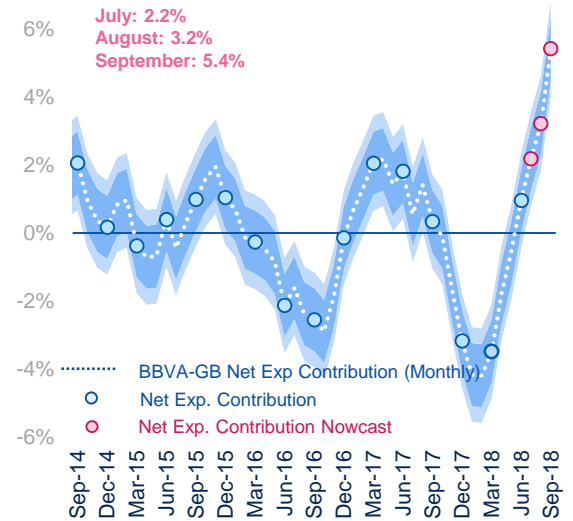
Turkey: Private Consumption*
(%YoY, mov. Avg. 3m)



Turkey: Total Investment
(%YoY, mov. Avg. 3m)



Turkey: Net Exports
(% Contribution to GDP Growth)



Employment trend is not immune and in some sectors the adjustment is becoming sizeable... (i.e. those boosted by the CGF)

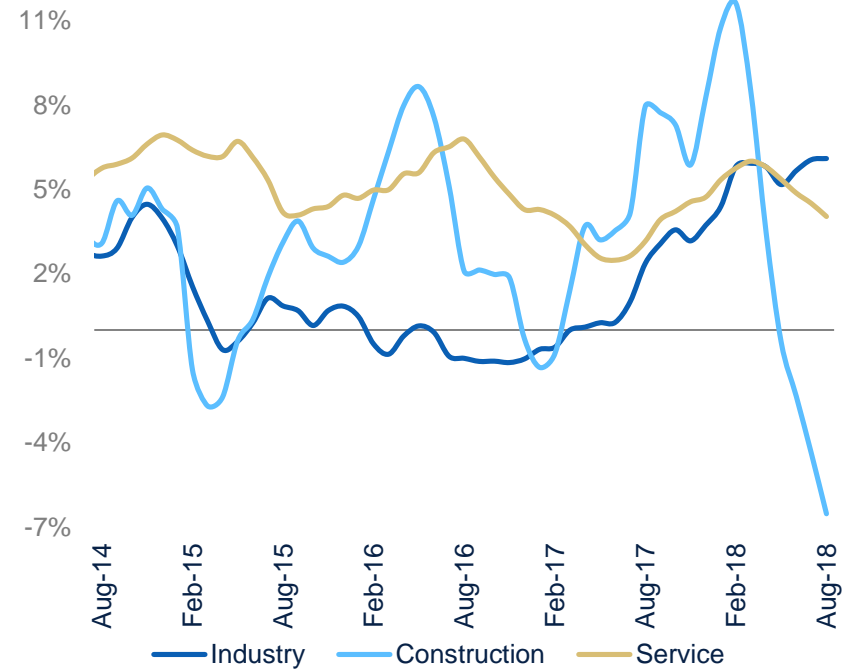
Unemployment rate

(SA, %)



Turkey: Employment growth by Sector

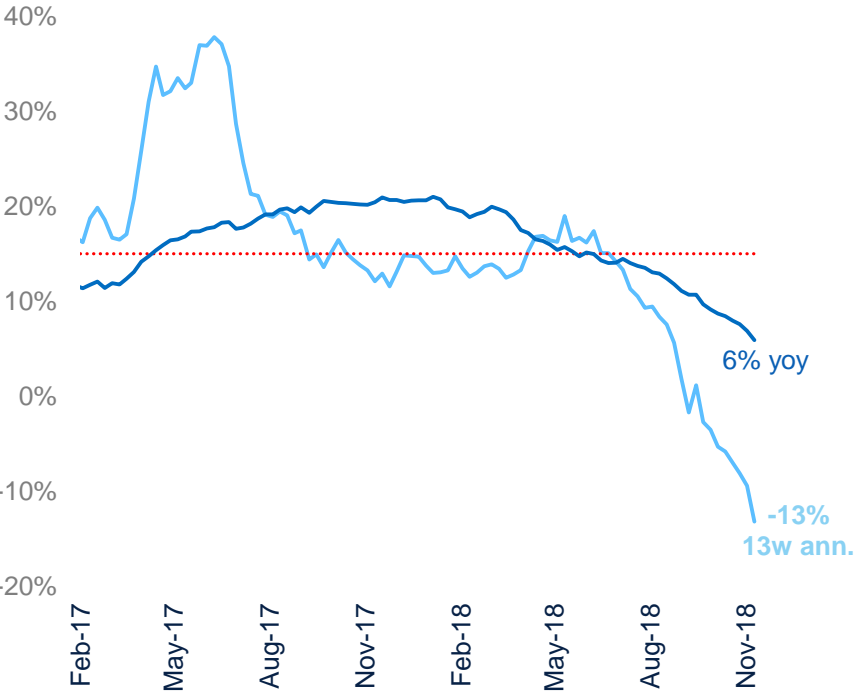
(3MA, YoY)



The domestic demand adjustment is related to the sudden stop in the loans evolution... the credit contraction is now more broad-based

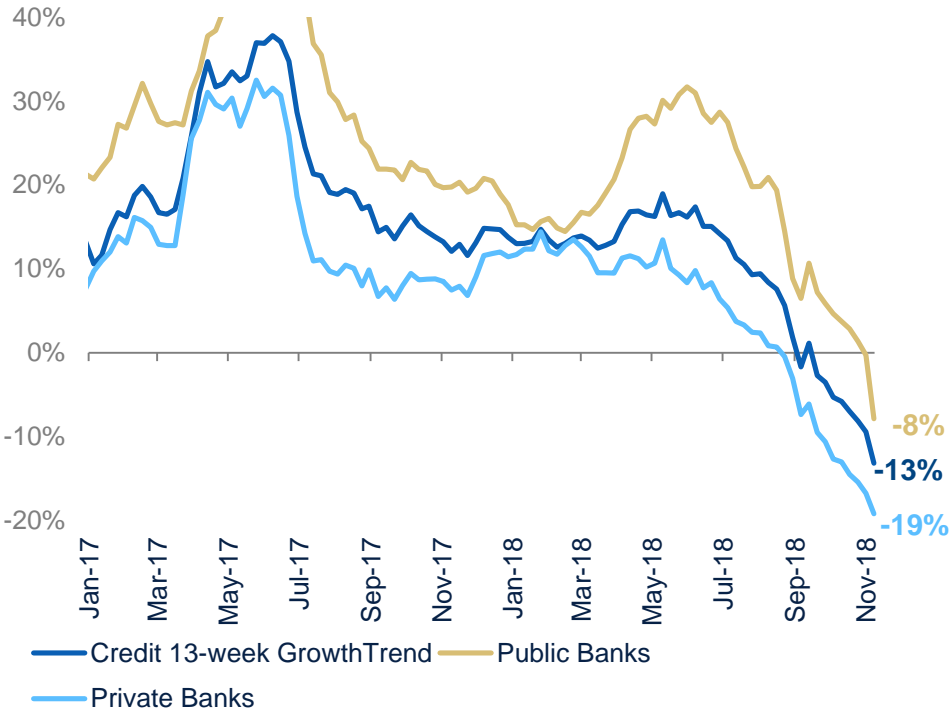
Credit Growth (FX adj)

YoY, Quarterly Annual Rate



Credit Growth (FX adj)

13-week, Quarterly Annual trend



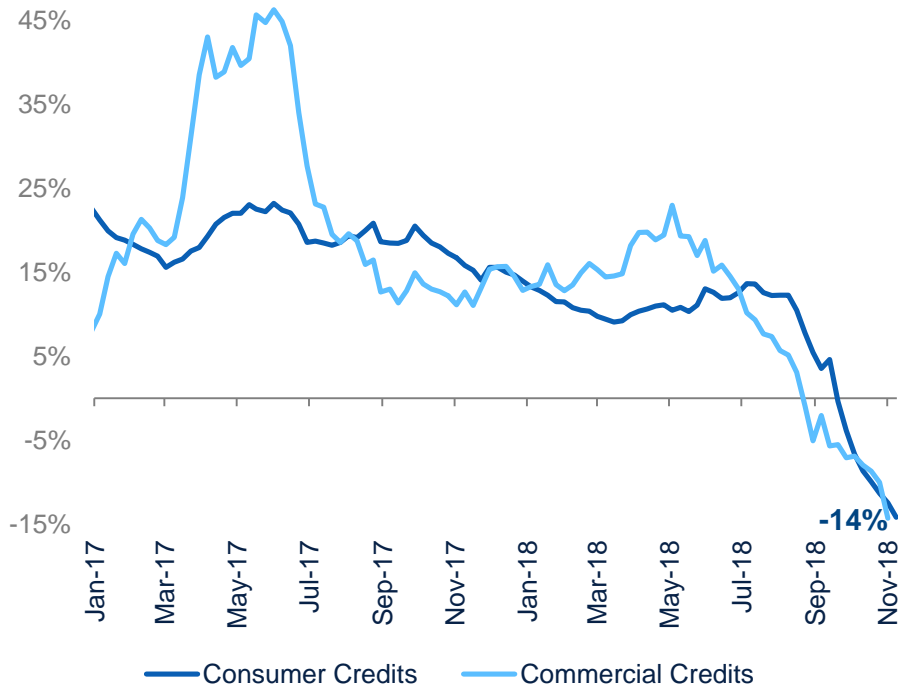
Source: CBRT, TURKSTAT, BBVA Research Turkey

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...with some differences in the consumer segments...

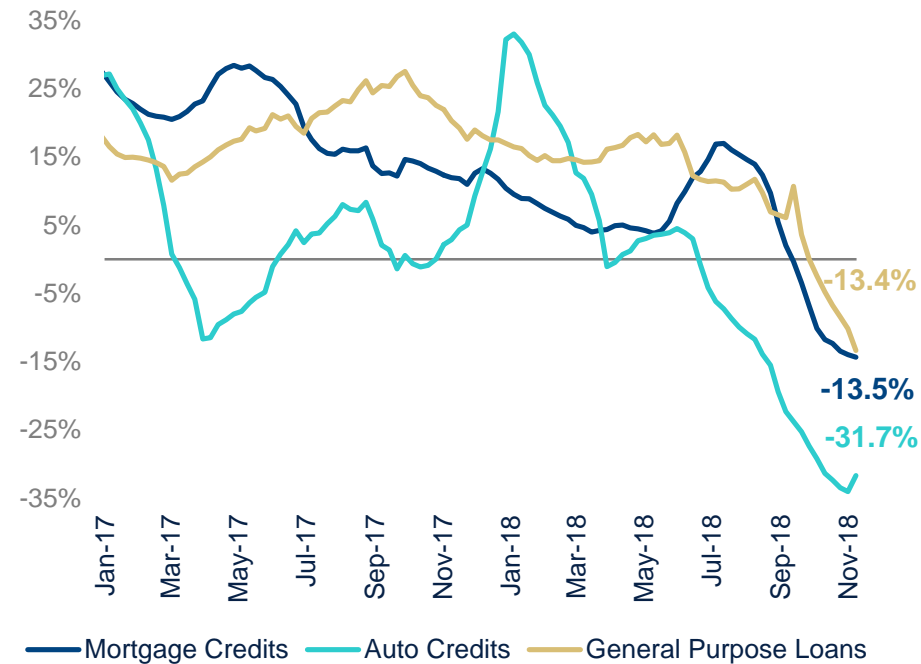
Credit Growth: Commercial vs Consumers

13-week, Annualized trend



Credit Growth (FX adj): Consumer

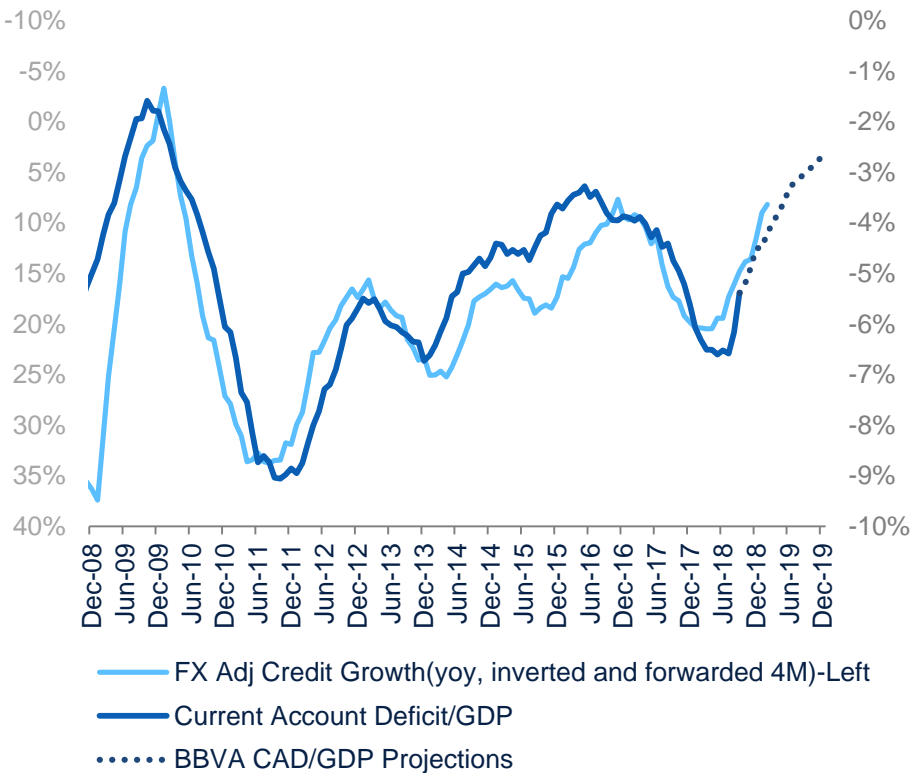
13-week, Annualized trend



Credit is linked to the external imbalance (overconsumption or low savings”) and is leading to a reversal of the current account deficit...

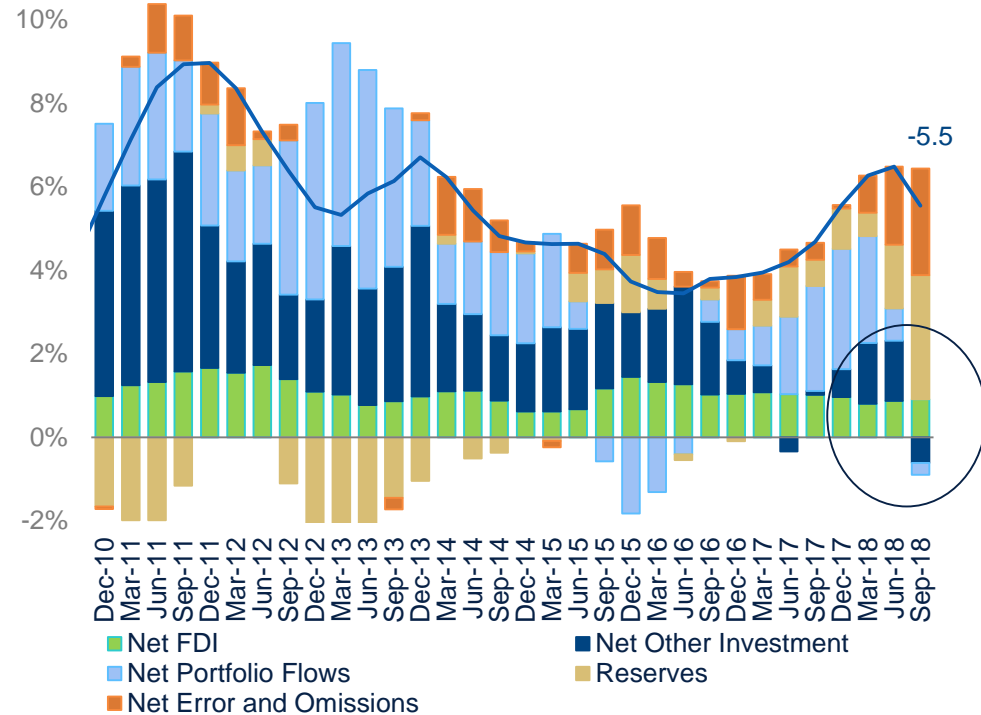
Turkey: Current Account and Credit Growth

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



Current Account Financing

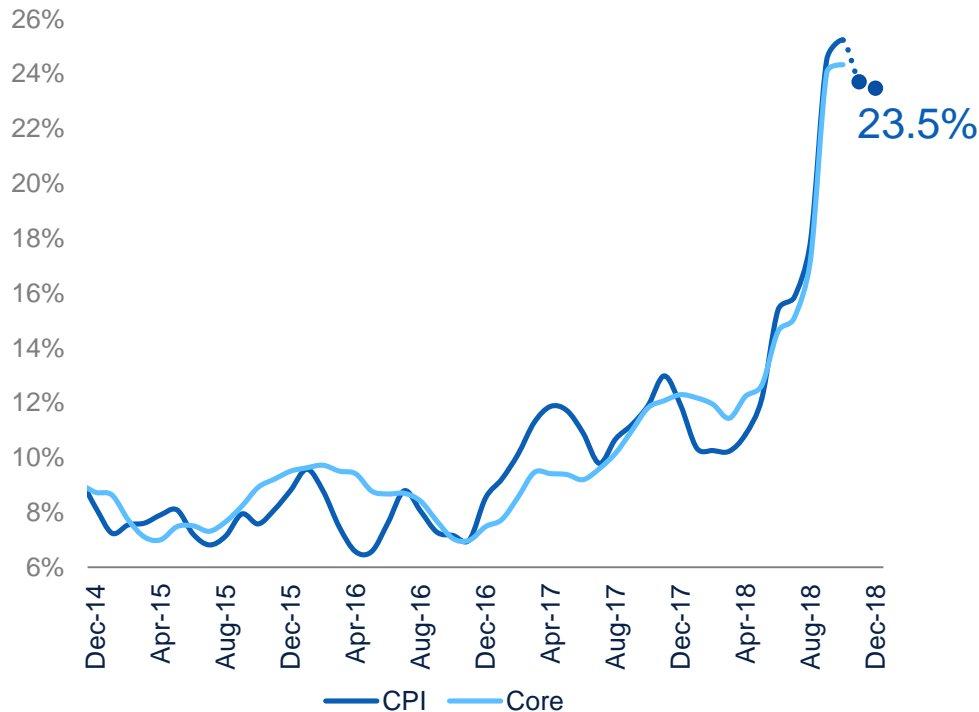
12M sum, % GDP



Inflation could decelerate in the short term due to tax reductions (1pp) and lagged effects of discount campaigns... but there will be a transitory reversal in 1Q-19 on base effects

Turkey: CPI and Core Inflation

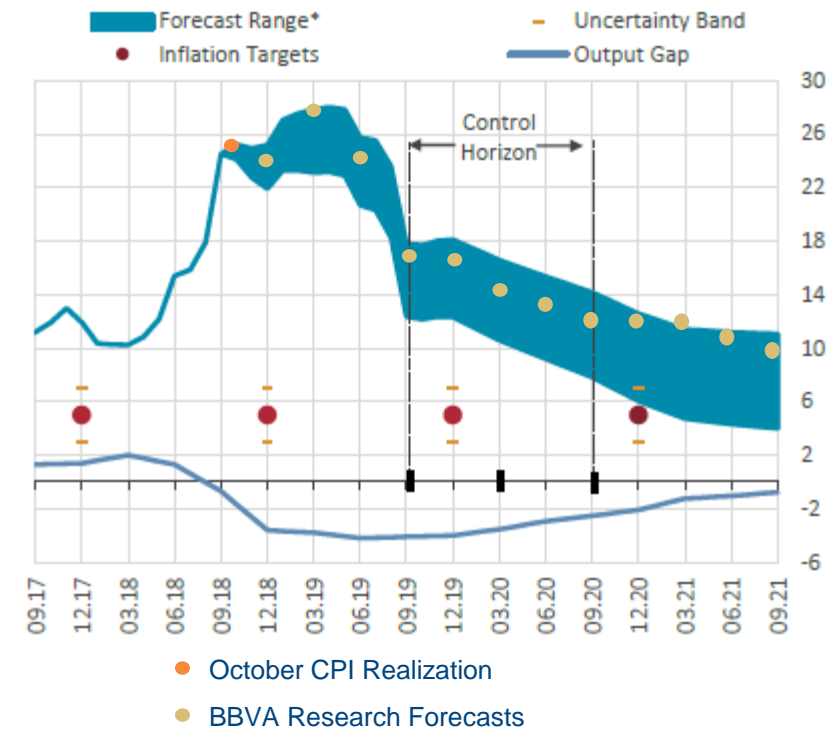
YoY



Source: CBRT, TURKSTAT, BBVA Research Turkey

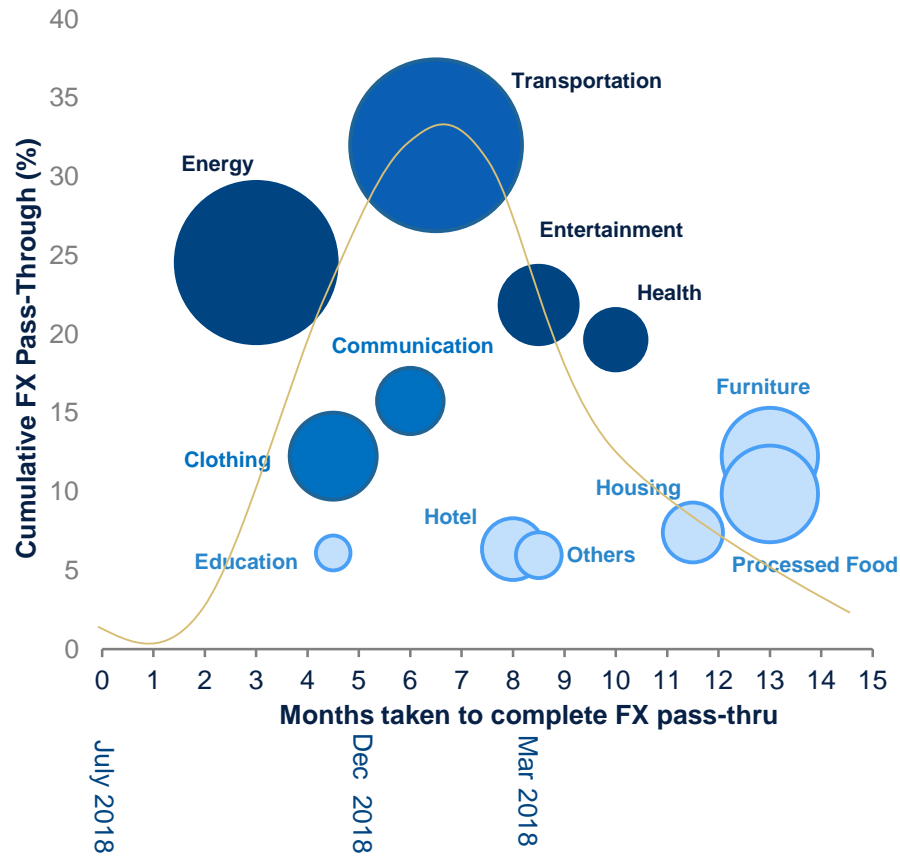
Turkey: CBRT Inflation Projections

October Inflation Report

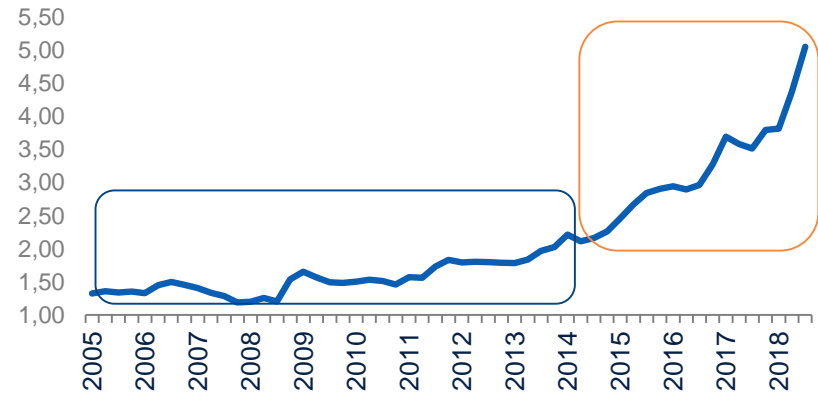


Upside risks from “far from homogeneous” pass-thru impact and duration on inflation... it will start to die out after the elections

Turkey: FX Pass-thru on Core D CPI Items*



Turkey: Exchange Rate vs USD

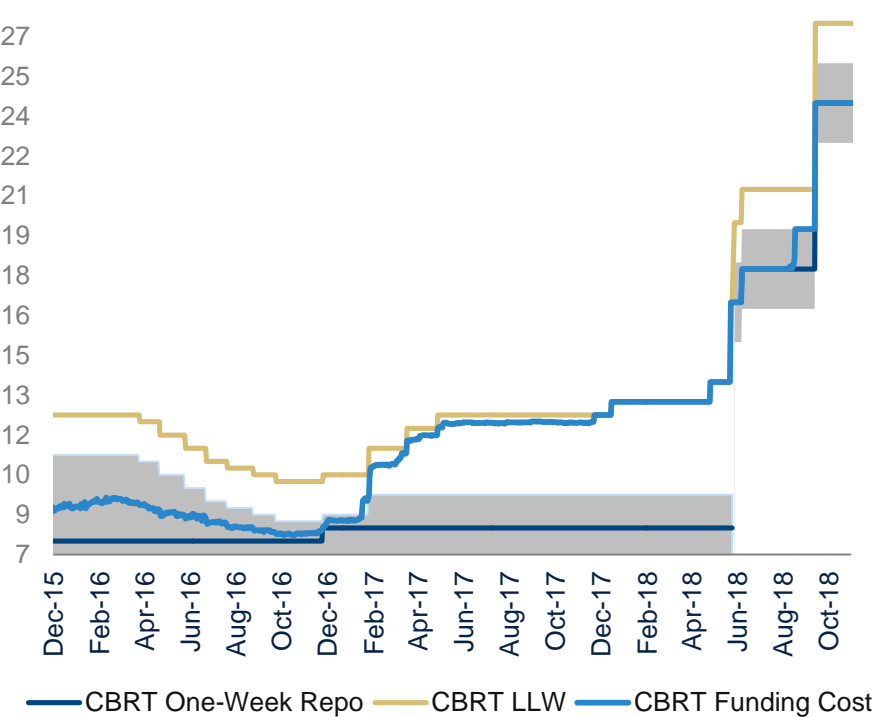


Source: CBRT, TURKSTAT, BBVA Research Turkey

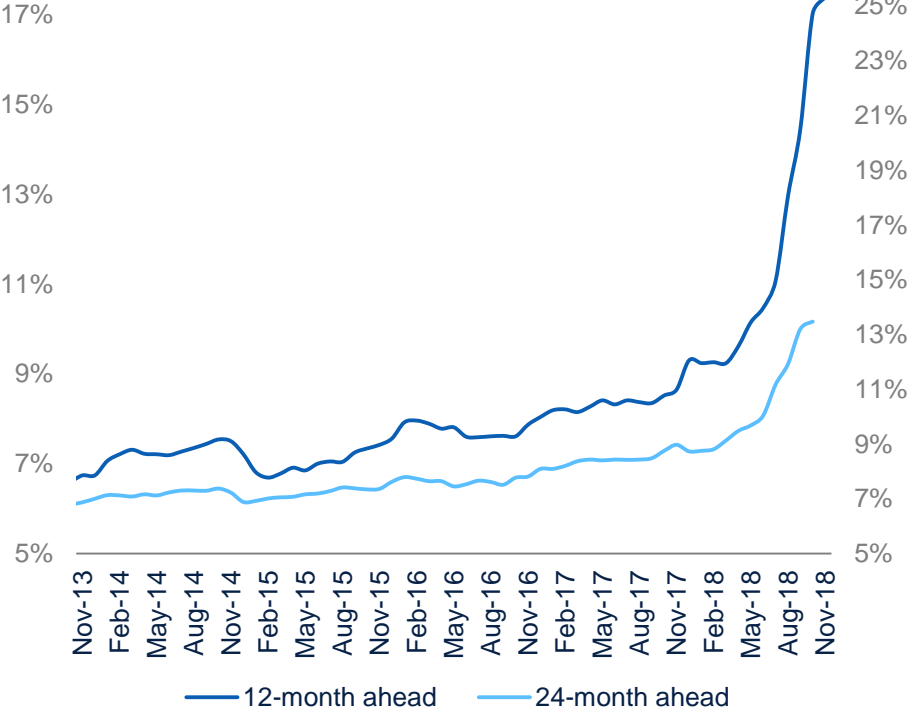
*Bubble size corresponds to the weight of each item in FX pass-thru to Core D CPI

Monetary Policy: The CBRT stayed on hold in October and given the recent exchange rate appreciation and the oil price evolution it will stay on hold until inflation expectations start to revert

CBRT Interest Rates
(Annual Level, %)



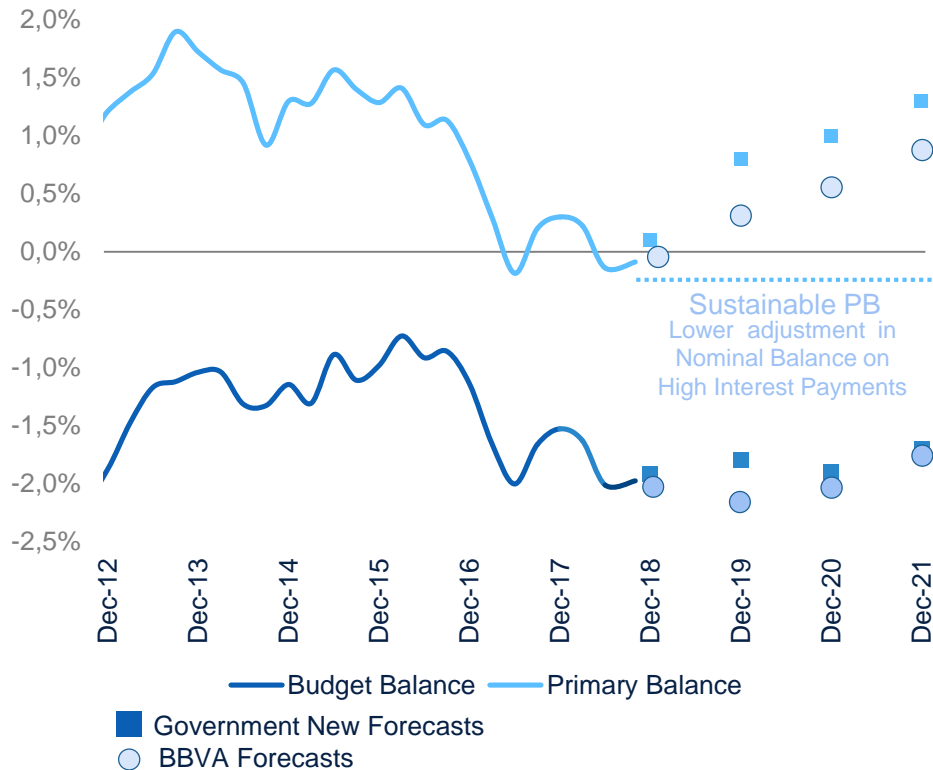
Inflation Expectations
(YoY)



Source: CBRT and BBVA Research Turkey

The fiscal plan is coherent but also challenging...

CG Budget Balance and NEP Forecasts % of GDP

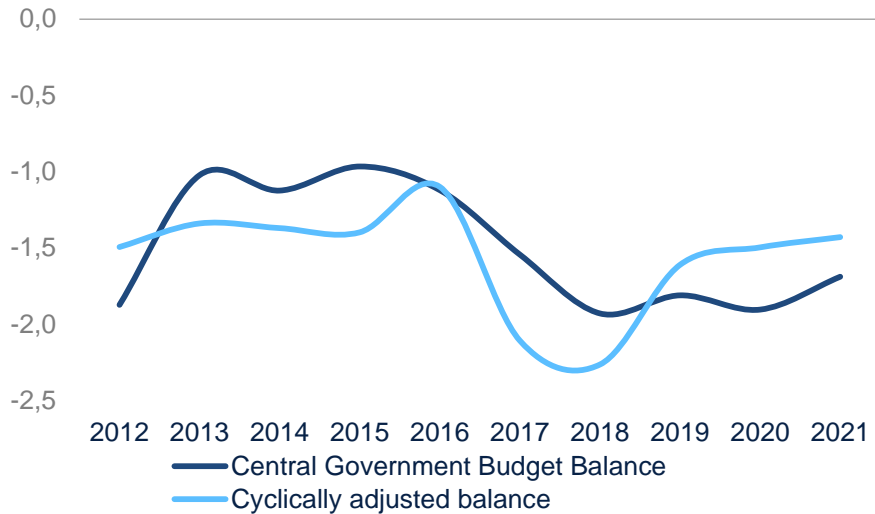


	2017	2018 (e)	2019 (f)	2020 (f)	2021 (f)
GDP Growth(%)	7.4	3.8	2.3	3.5	5.0
Domestic Demand	7.3	2.4	0.8	3.3	4.8
External Demand	0.1	1.4	1.5	0.2	0.2
Unemployment Rate(%)	10.9	11.3	12.1	11.9	10.8
USD/TRY(Year Avg)	3.6	4.9	5.6	6.0	6.2
Inflation Rate(eoy %)	11.9	20.8	15.9	9.8	6.0
Central Gov. BudgetBalance (% GDP)	-1.5	-1.9	-1.8	-1.9	-1.7
Central Gov. PrimaryBalance (% GDP)	0.3	0.1	0.8	1.0	1.3
Current AccountBalance (% GDP)	-5.6	-4.7	-3.3	-2.7	-2.6
EU Defined Gov.Debt (% GDP)	28.3	31.1	28.5	28.2	27.2

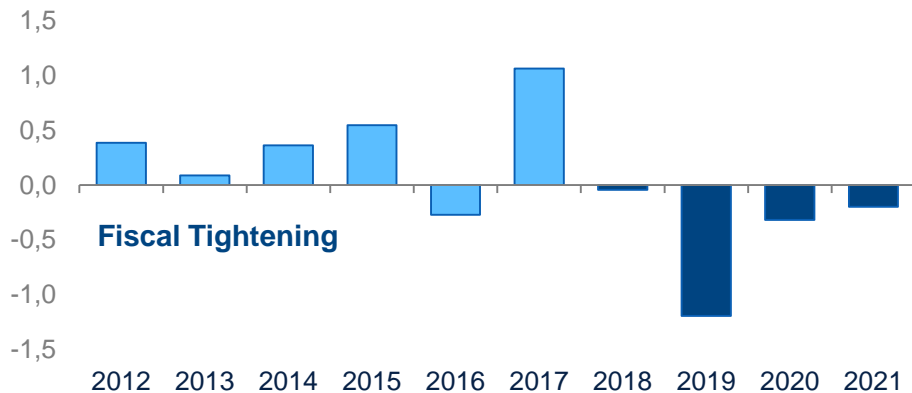
As includes huge fiscal consolidation efforts in 2019 which the government will have to accelerate...

Turkey: Central Government Balance

% of GDP

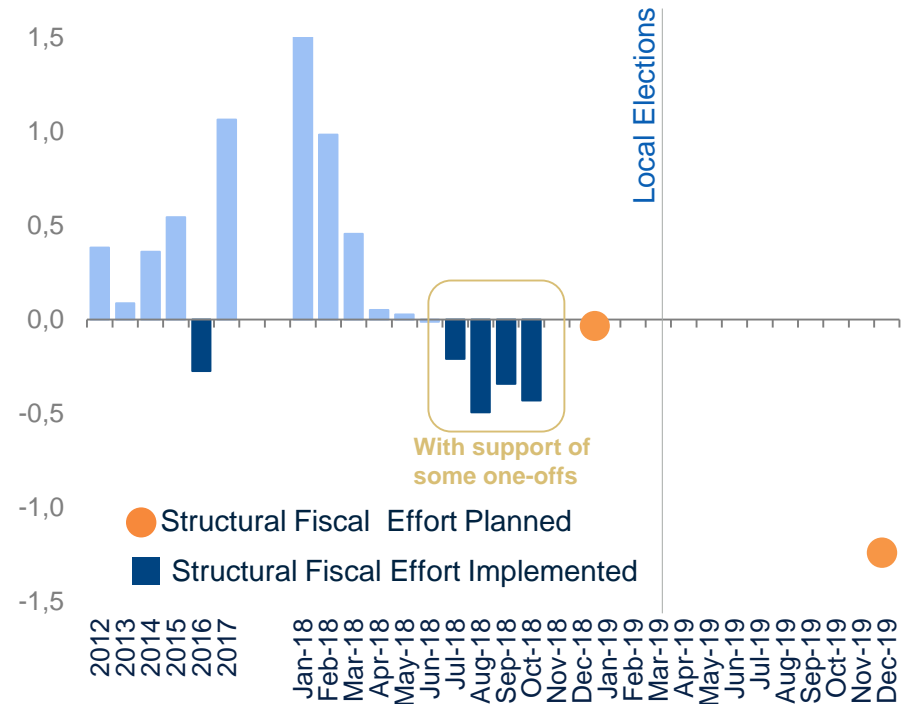


Fiscal Easing



Turkey: Fiscal Effort Tracker*

(12m Cumulative change in cyclically adjusted balance, % 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)
- reducing current expenditures (0.1%).
- higher interest expenditures (2.2% and 2.8% of GDP in 2018 and 2019).

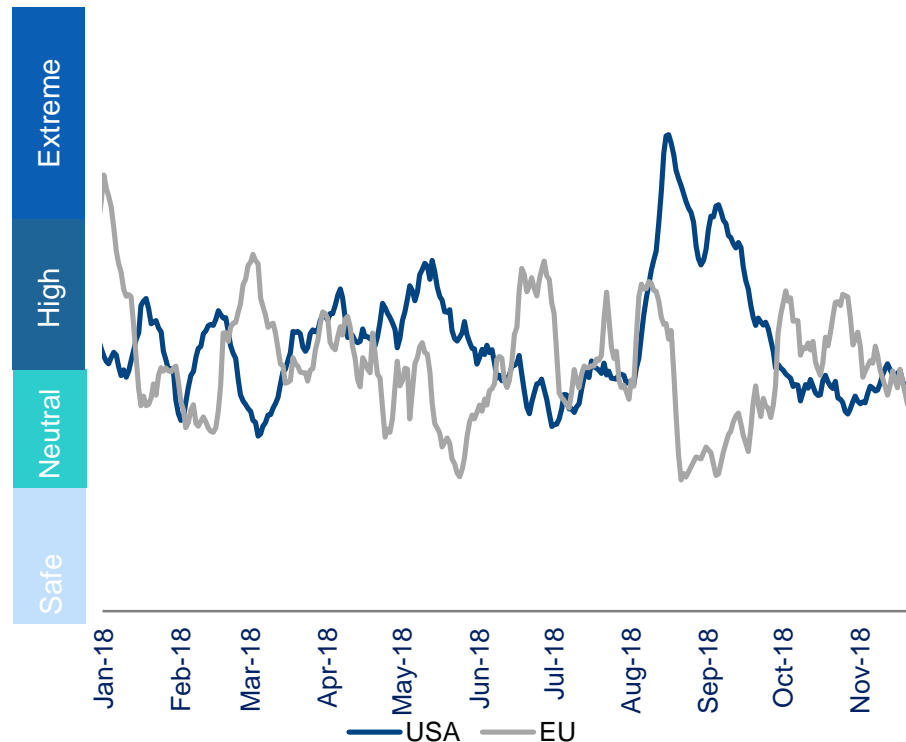
On the revenue side, the Government extra revenues (0.4% of GDP) in 2019

*2018 figures correspond to 12-month sum

Geopolitics have provided some tailwinds...

Turkey: Foreign Relationships Index

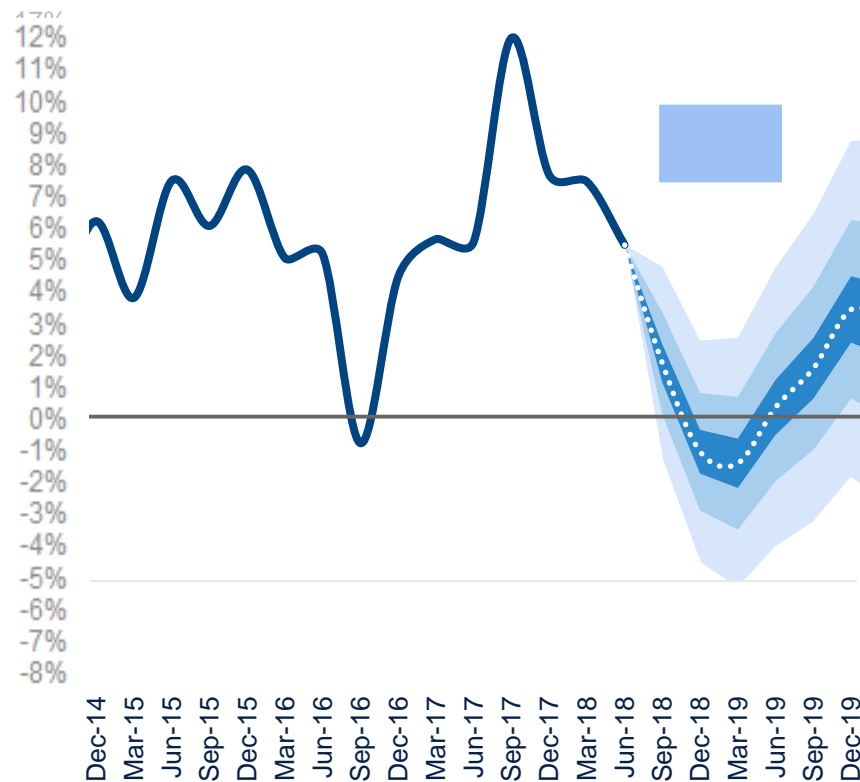
(negative change in cyclically adjusted balance, % of GDP)



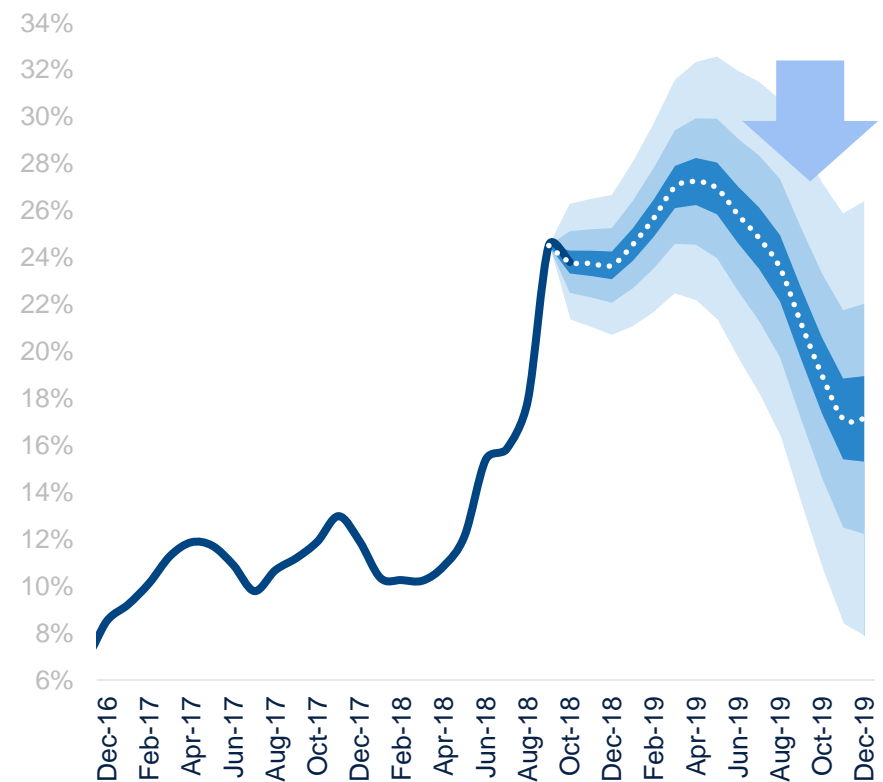
- ◆ Reverend Brunson was finally released after the reduction of the penalty. A critical step in the right direction.
- ◆ The removal of Magnitsky act was good news and a manageable Halkbank penalty could be delivered
- ◆ But still important issues to restore “trust” between US and Turkey particularly AS-400 , YPG and Iran
- ◆ The Saudi Arabia Consulate Affairs ease negotiations

Our GDP forecast remains “balanced” in the short term. Some downside inflation risks, supported by exchange rate and oil prices

GDP Forecast (YoY)



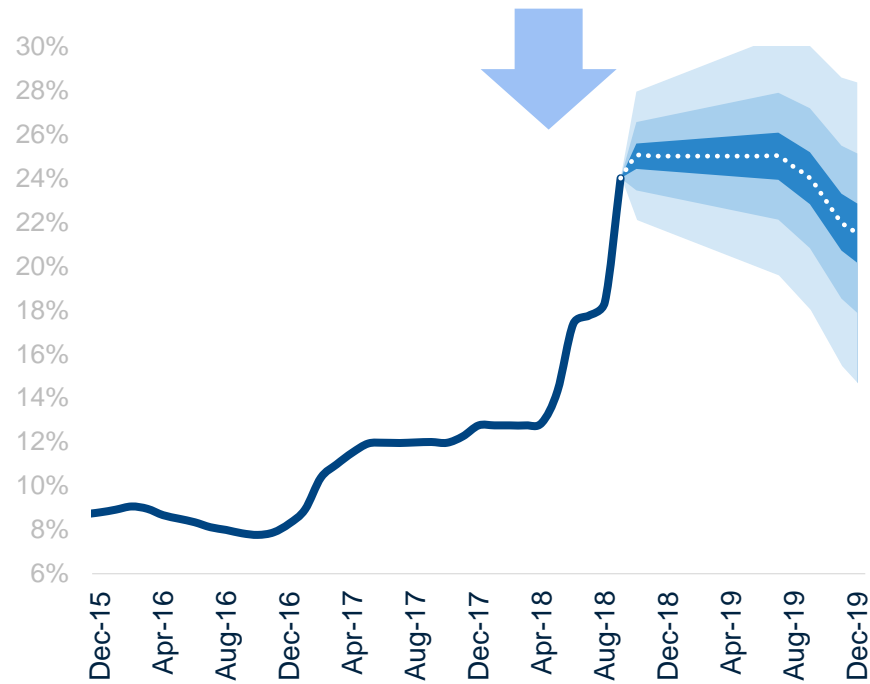
Inflation Forecast (3m YoY)



Monetary policy should remain “tight” until inflation expectations are curbed, with some downside risks in the second half of 2019. Exchange rate positive reaction poses clear appreciation risks

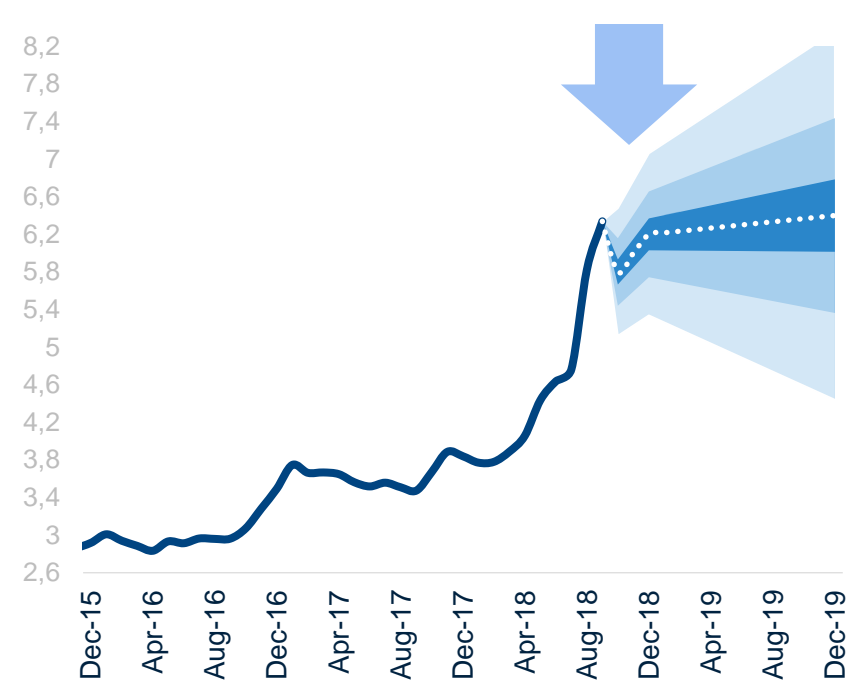
Monetary Policy Forecasts

% CBRT Funding Cost



Exchange Rate Forecasts

USDTRY Level



Turkey: Base Case Scenario

BaseLine Scenario	2017	2018	2019	2020	2021	2022	2023
GDP (yoy)	7.4	3.0	1.0	2.5	4.5	4.5	4.5
Unemployment Rate (% avg)	10.9	11.3	13.5	12.8	11.5	10.5	10.0
Domestic Demand	7.3	1.8	-1.1	2.1	4.8	4.6	4.5
External Demand (pp)	0.1	1.2	2.1	0.3	-0.2	0.0	0.0
Inflation (eoy)	11.9	23.5	17.0	12.0	9.0	8.0	7.0
Inflation (avg)	11.1	16.7	22.5	13.2	10.7	8.4	7.4
Policy Rate (% eoy)	12.75	24.00	21.50	15.00	12.00	11.00	10.50
TRY/USD (eoy)	3.77	6.20	6.40	6.55	6.75	7.00	7.00
TRY/USD (avg)	3.65	4.96	6.31	6.48	6.66	6.89	7.00
Central Government Balance/GDP	-1.5	-2.1	-2.2	-2.0	-1.7	-1.6	-1.5
Current Account Balance / GDP	-5.5	-5.1	-2.7	-2.6	-3.4	-3.6	-3.8
Loans Growth (FX adjusted)	24.0	5.4	3.3	10.0	14.3	14.6	14.6

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