

# Turkey

Strong Cycle, but red alert on fundamentals

Stress free country monitoring

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# Forecasts

	2013	2014	2015	2016	2017	2018
Real GDP growth (%)	8.5%	5.2%	6.1%	3.2%	7.1%	6-7%
Households	7.9%	3.0%	5.4%	3.7%	5.2%	
Government	8.0%	3.1%	3.9%	9.5%	11.4%	
Investment	13.8%	5.1%	9.3%	2.2%	3.8%	
Exports	1.1%	8.2%	4.3%	-1.9%	9.9%	
Imports	8.8%	-1.7%	-8.0%	0.5%	6.7%	
Nominal GDP (USD bn)	1810	2044	2339	2609	3100	
TRY per USD	2.14	2.32	2.91	3.52	3.78	3.75-4.5
CPI, tcmb	7.4%	8.2%	8.8%	8.5%	10.8%	9.0%
Gross external debt (USD bn)	371	398	400	413	420	430
FX reserves (USD bn)	107	108	100	96	82	73
Unemployment rate	9.0%	9.9%	10.3%	10.9%	11.3%	10.5%
Wage growth (%)	14%	16%	14%	16%	15%	15%
Mortgage rates (new business)	9.7%	11.9%	12.3%	13.3%	16.1%	18.1%
Fiscal balance (as % of GDP)	-1.2%	-1.4%	-1.2%	-1.6%	-2.4%	-1.8%
Public debt (as % of GDP)	34%	32%	31%	31%	28%	31%

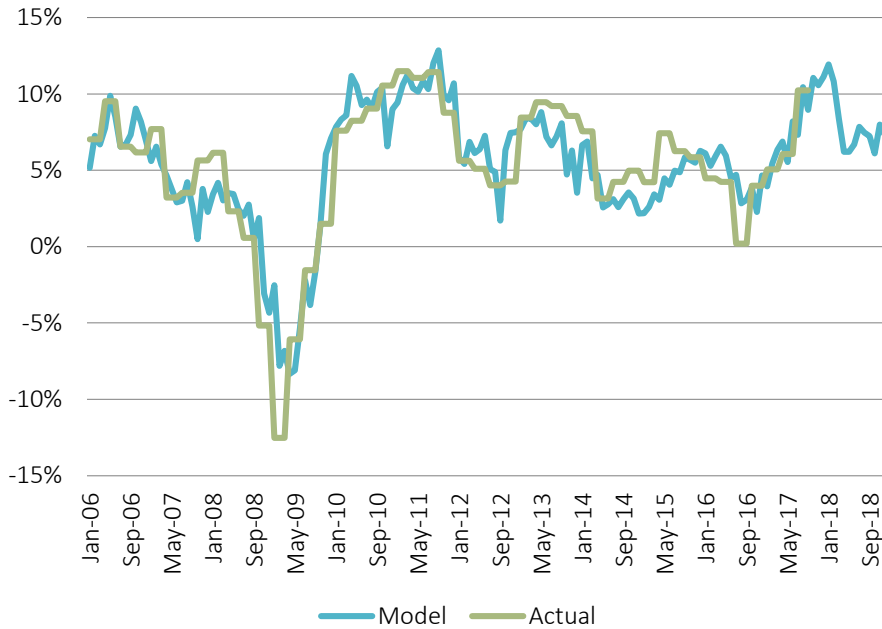
Sources: macrobond, CEIC, ADA Economics

# Key messages

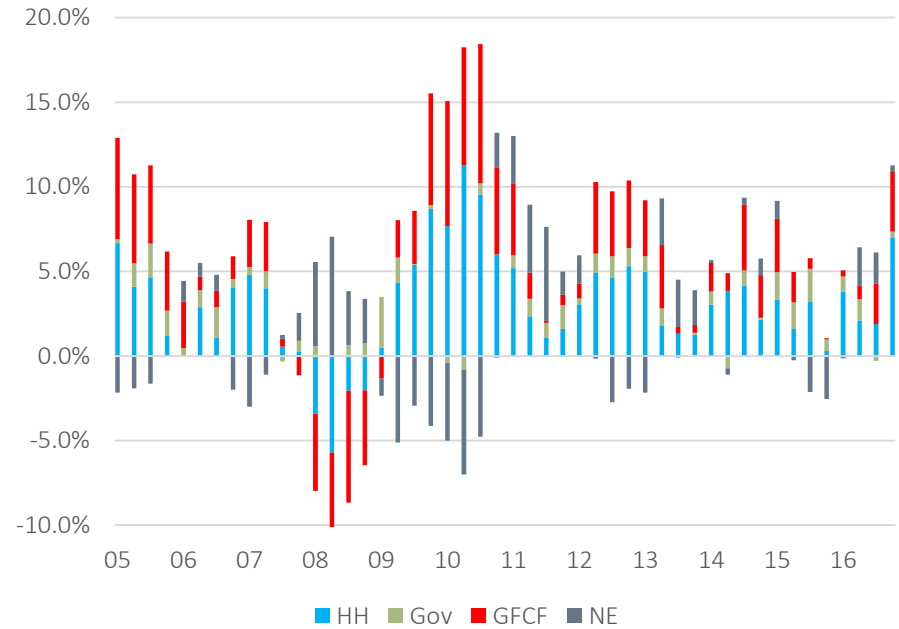
- Our models for economic growth in Turkey suggest 2018 may prove to be as strong as 2017, with real GDP expanding 6-7%. The key ingredients remain: fast credit growth, a very favorable global backdrop (including with low interest rates) and the stabilizing force of the weak lira.
- From a structural perspective there are some cracks emerging: housing affordability is deteriorating, funding for the current account is getting tighter as a trend (though it may see a transitory improvement near term) and the amount of leverage accumulated in the non-financial corporate sector has reached levels that from international experience would begin to ring alarm bells.
- Foreign positioning in local bonds has increased, but is USD10-15bn below previous peaks on a 12m-rolling basis. This means that there is potential for some yield compression and some currency appreciation
- However, the funding for the current account deficit has been tight since last year and it is going to get tighter. For this reason, as a trend lira could easily weaken to 4.5-5 against the euro in the next 12-15 months.
- In our view, the cost of borrowing will rise – and it is rising already at the retail level – regardless of whether the central bank will hike or not. FX reserves are falling and relative to imports they are becoming modest. The weak lira is a stabilizing force for the economy, so we expect the CBT to tolerate it as long as the timing is not too inconvenient relative to the inflation seasonality and the political calendar

# GDP: drivers and outlook

## Nominal GDP growth & projections



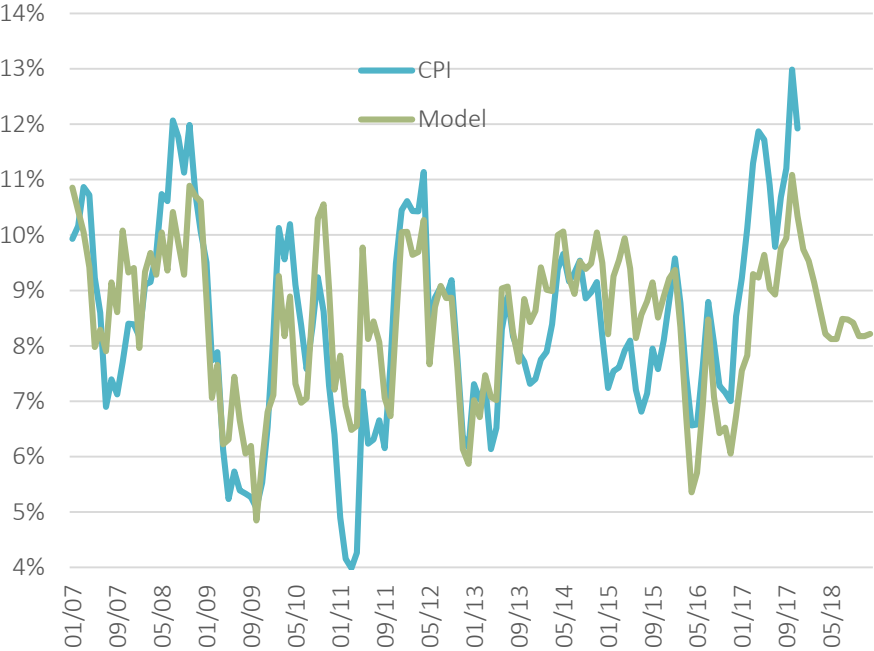
## Contributions to yoy GDP growth



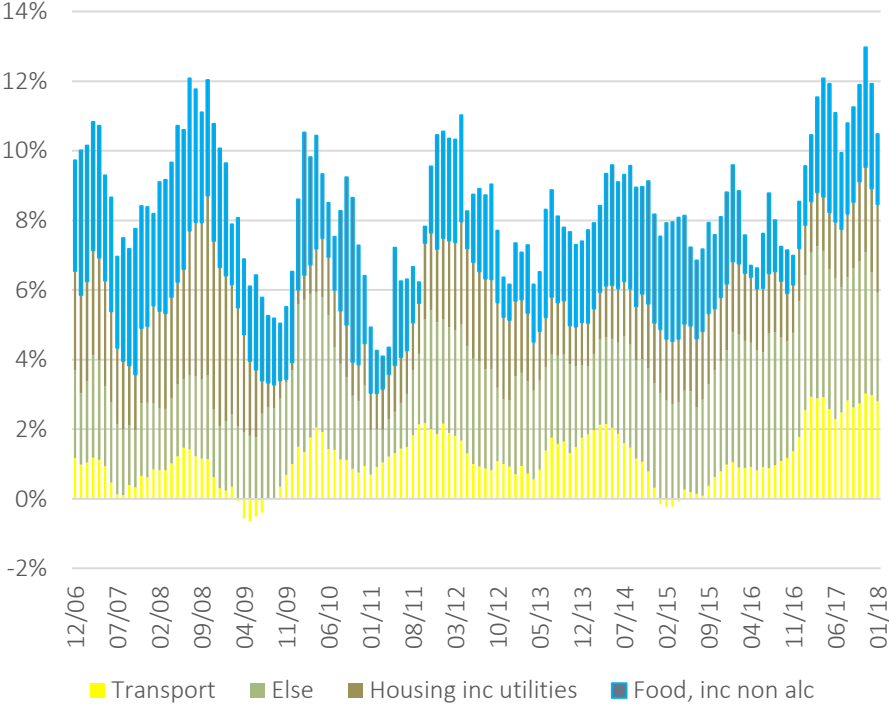
The econometric model to forecast YoY real growth implements as explanatory variables unemployment, growth in total credits, growth in lagged exports, and lagged consumer confidence.

# GDP drivers – quick overview of contributions by sectors

Inflation projections



Contributions to yoy GDP growth

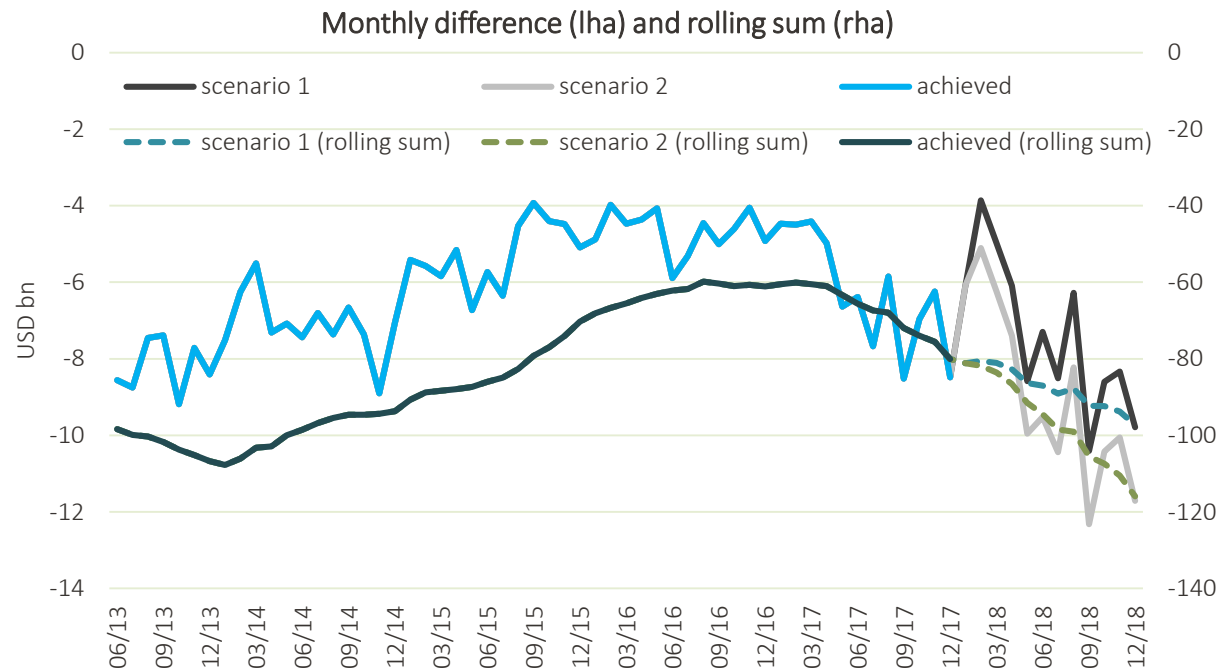


The econometric model to forecast YoY implements as explanatory variables lagged output gap, unemployment rate, food prices, and exchange rates.

Sources: Macrobond, CEIC, ADA Economics



# Balance of Trade

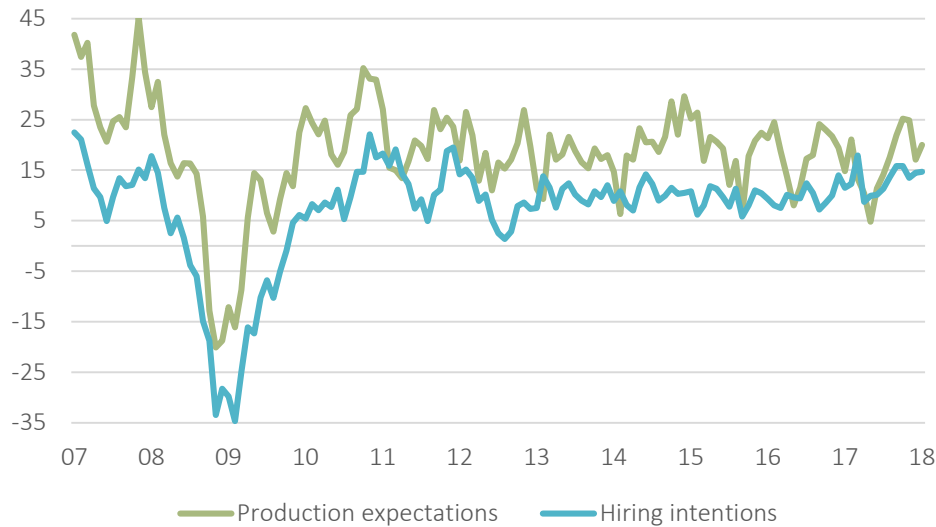


This model to forecast Trade Balance, separately forecasts imports and exports before estimating trade deficit. The separate models integrate as key variables exchange rate, oil prices lagged services confidence, lagged M2, lagged leading cyclical indicator, and lagged interbank rate. Scenario 1 assumes a TRYUSD exchange rate of 3.7 and Brent price of 55\$ a barrel as 2018 average, while Scenario 2 assumes an average exchange rate of 4.5 and average Brent price per barrel of 65. Depending on the two scenarios, the model expect the average trade deficit of Turkey to widen from 18% (Scenario 1) to 42% (Scenario 2).

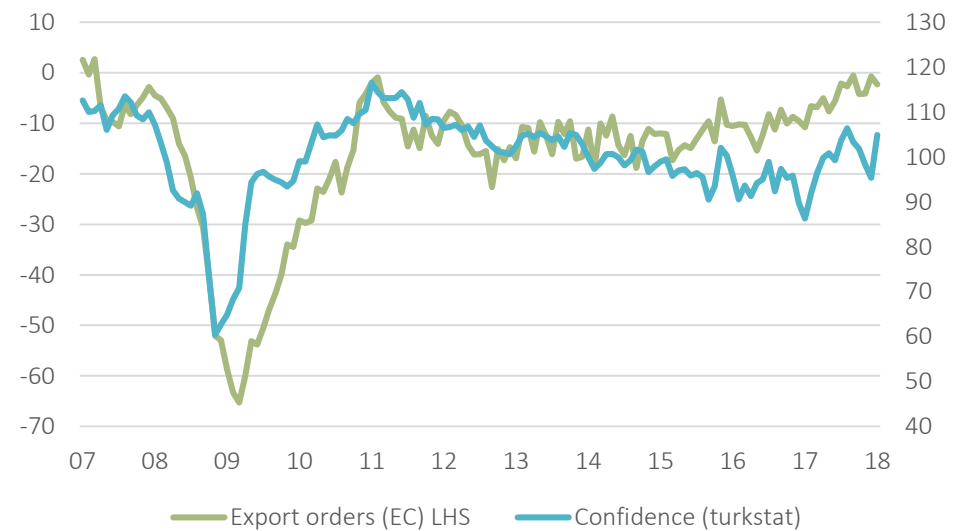
Sources: Macrobond, CEIC, ADA Economics

# Sentiment: better industry, stable construction

## Order expectations



## Industrial sentiment and export expectations

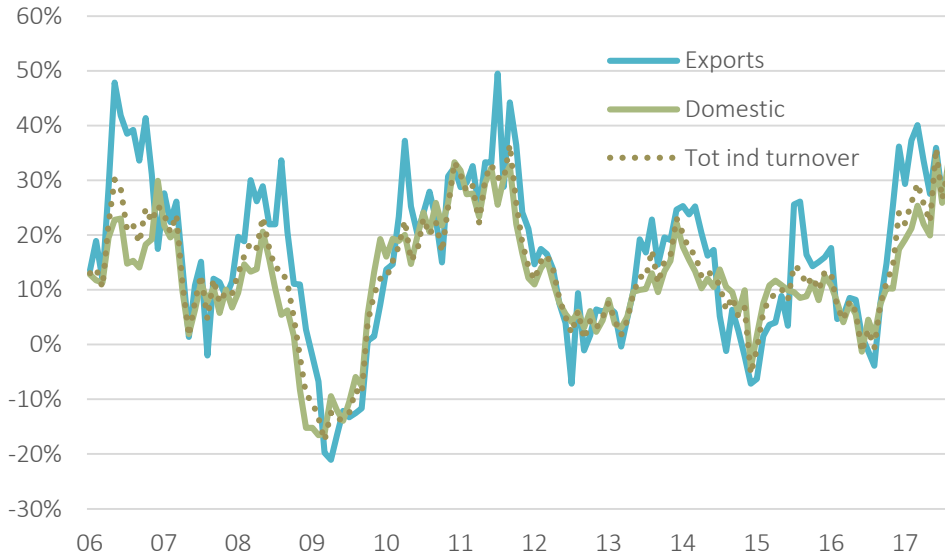


- Industrial confidence rising
- Hiring appetite up

Sources: Macrobond, CEIC, ADA Economics

# Sentiment: better industry, stable construction

## Industrial turnover YoY



## Manufacturing capacity utilisation



Strong demand internally & external

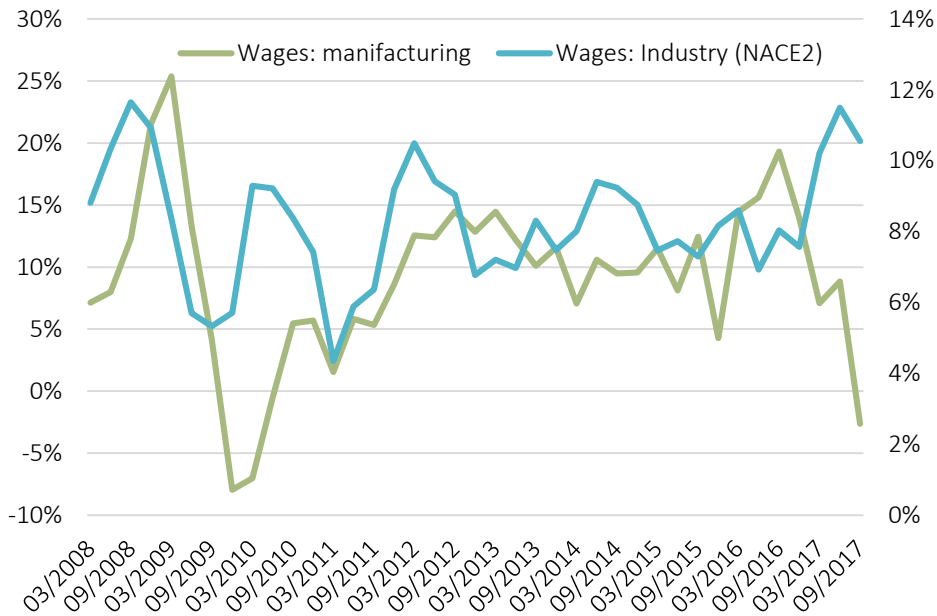
Capacity constrains keep on rising, supporting investment

Sources: Macrobond, CEIC, ADA Economics

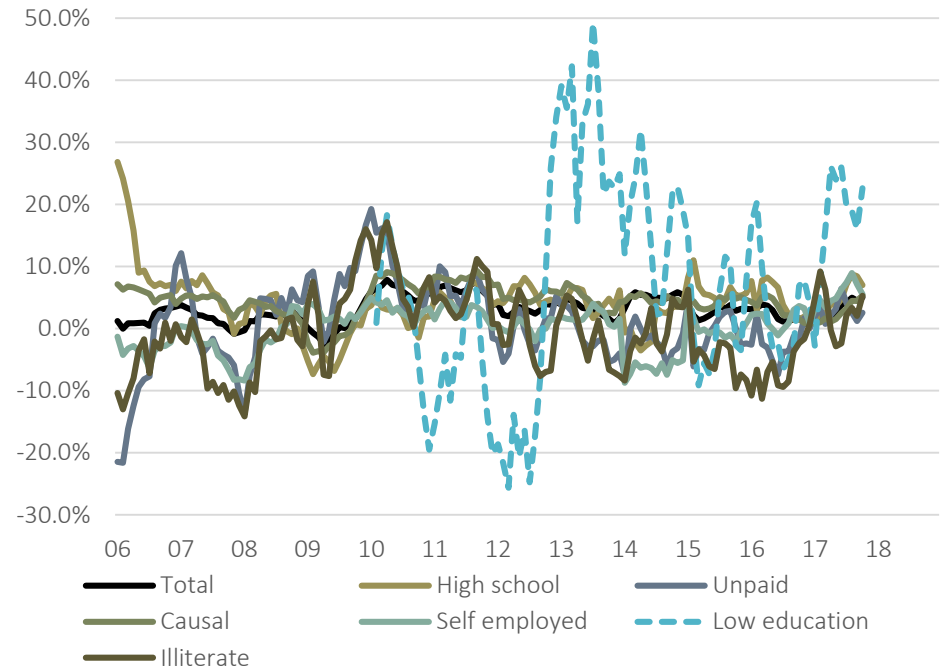


# Labour market: strong but composition is favourable to low pay

Growth in wages in manufacturing (lha) vs total industry (rha)



Employment by type of education



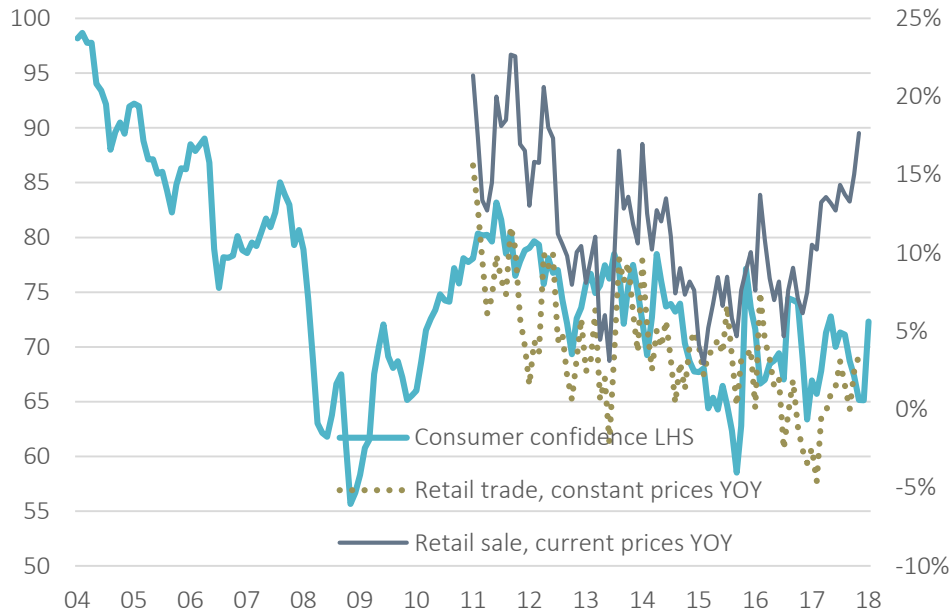
Job creation is strong

..but wage pressures relatively modest for Turkey's historical standards and given high inflation

Sources: Macrobond, CEIC, ADA Economics

# Real estate brewing problems

Retail sales growth fairly weak in constant prices



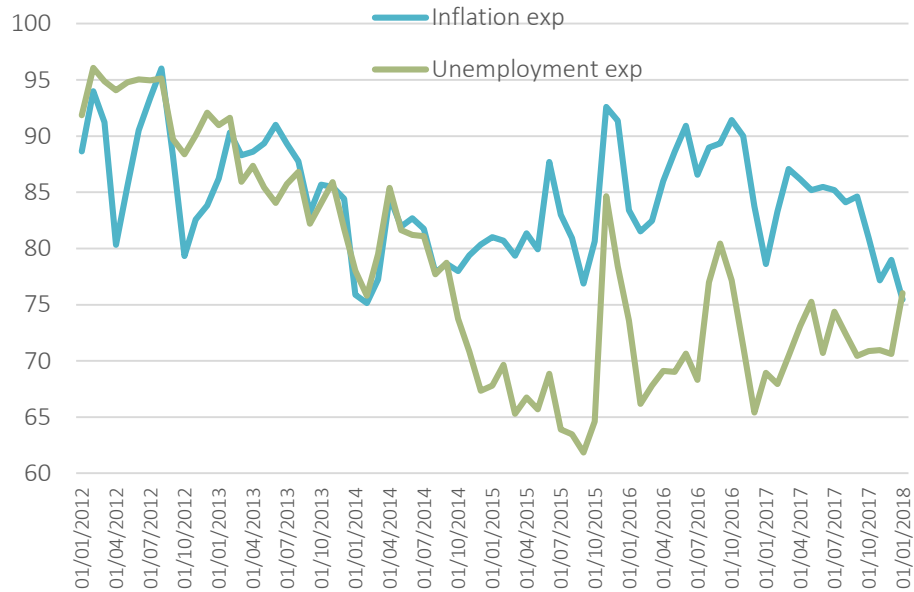
...wage expectations going up



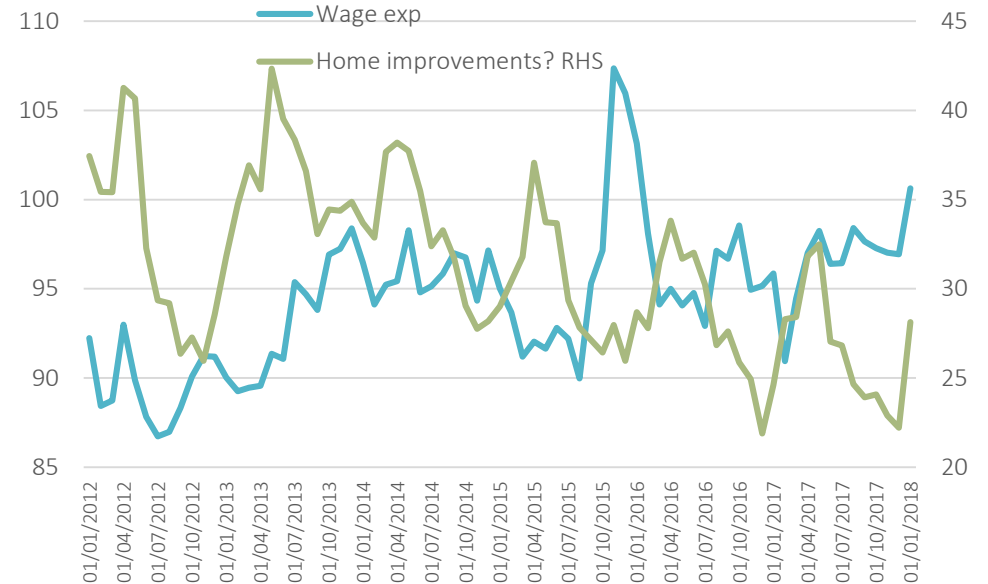
Sources: Macrobond, CEIC, ADA Economics

# Household sector

Falling CPI concerns, but rising unemployment fears



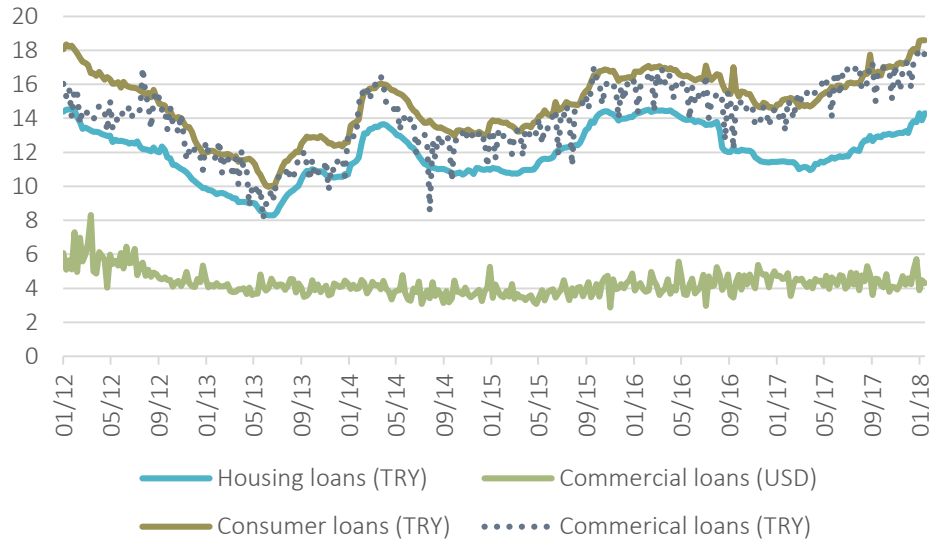
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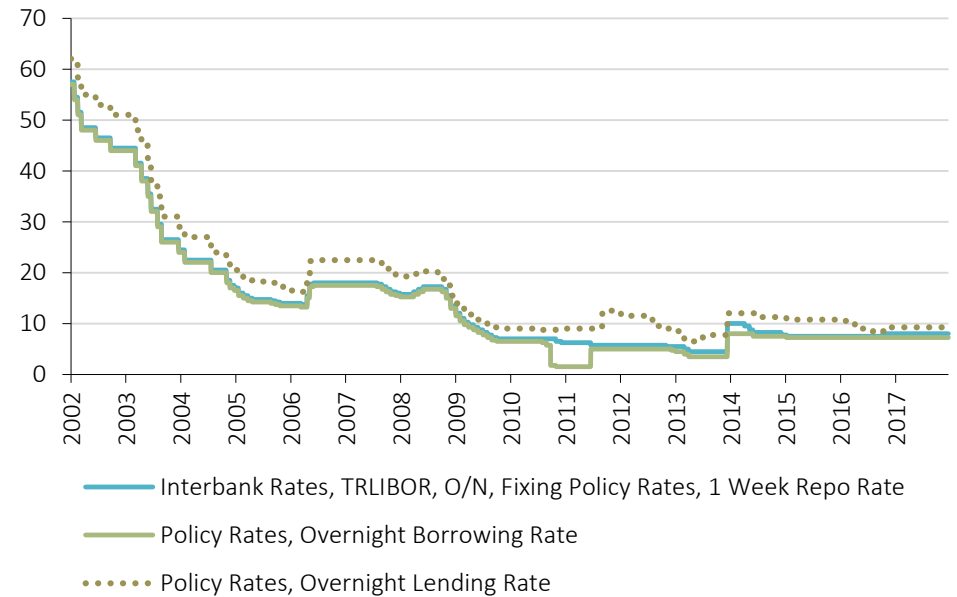
Sources: Macrobond, CEIC, ADA Economics

# Borrowing costs

## Retail sales lending rates



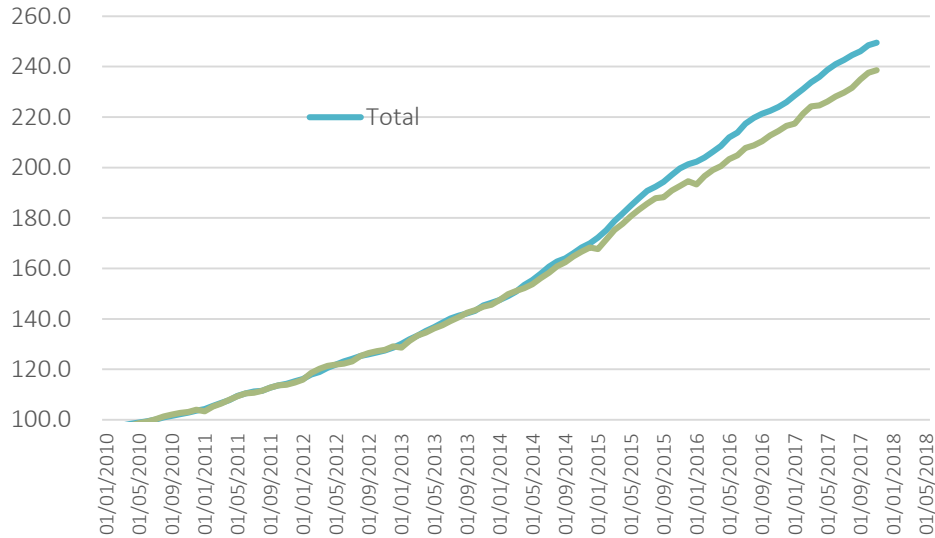
## Policy rate corridor



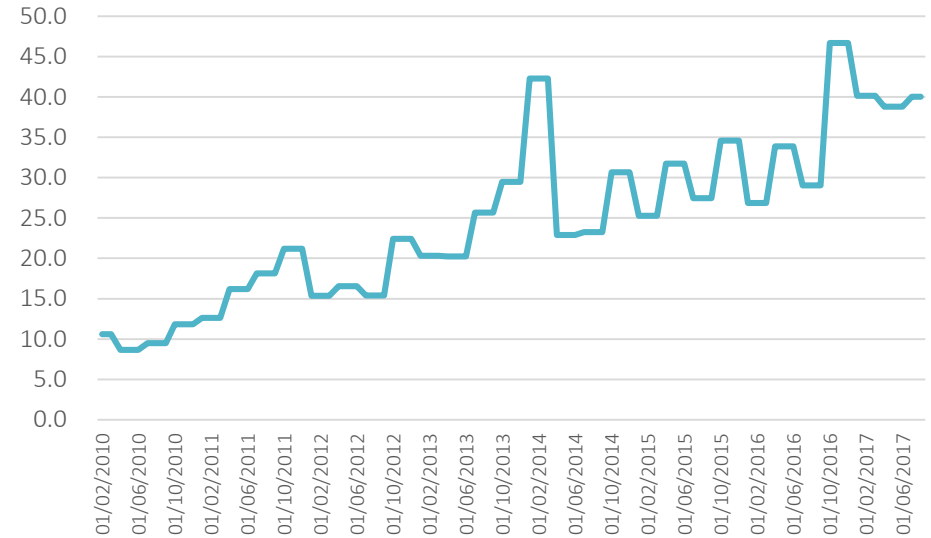
Sources: Macrobond, CEIC, ADA Economics

# Real estate brewing problems

House prices are very high!



...as are construction permits!\*

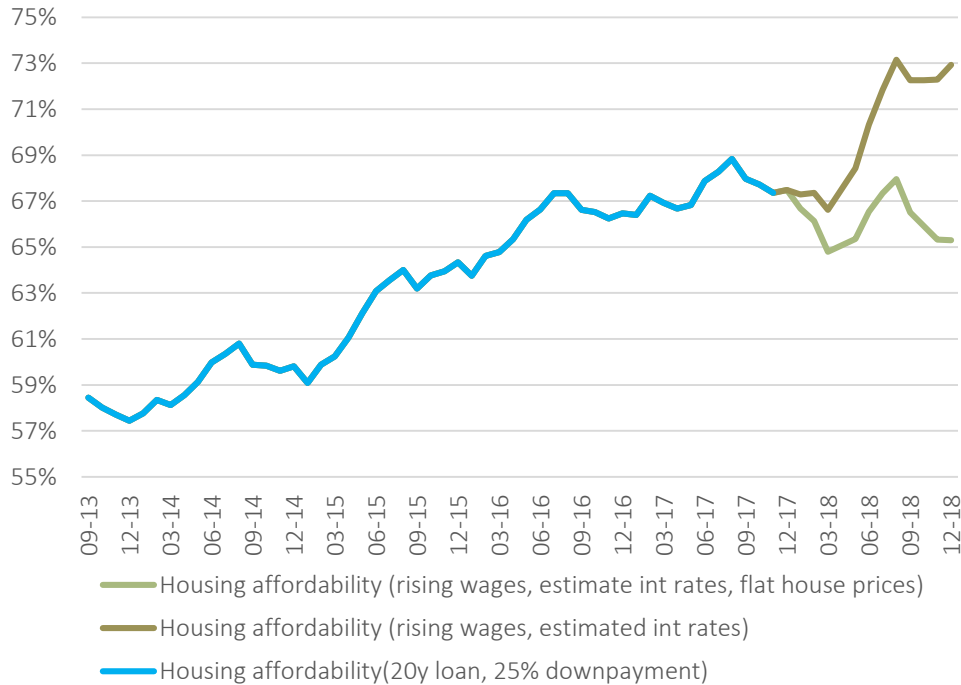


House prices appear high even given the strong economy  
Momentum in construction remains high

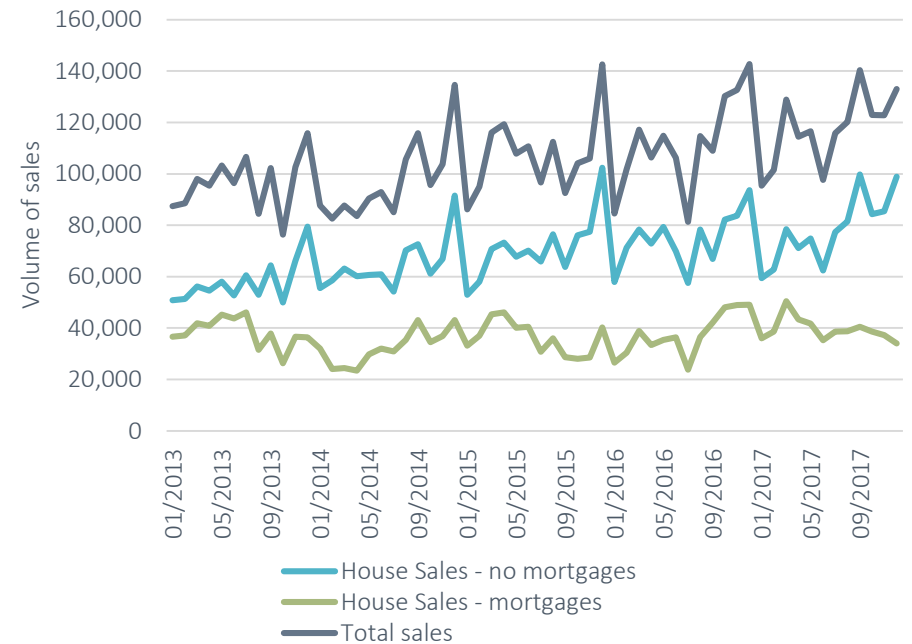
Sources: Macrobond, CEIC, ADA Economics

# Real estate brewing problems

## Higher debt servicing costs in 2018



## ...Mortgages portion bound to continue decreasing

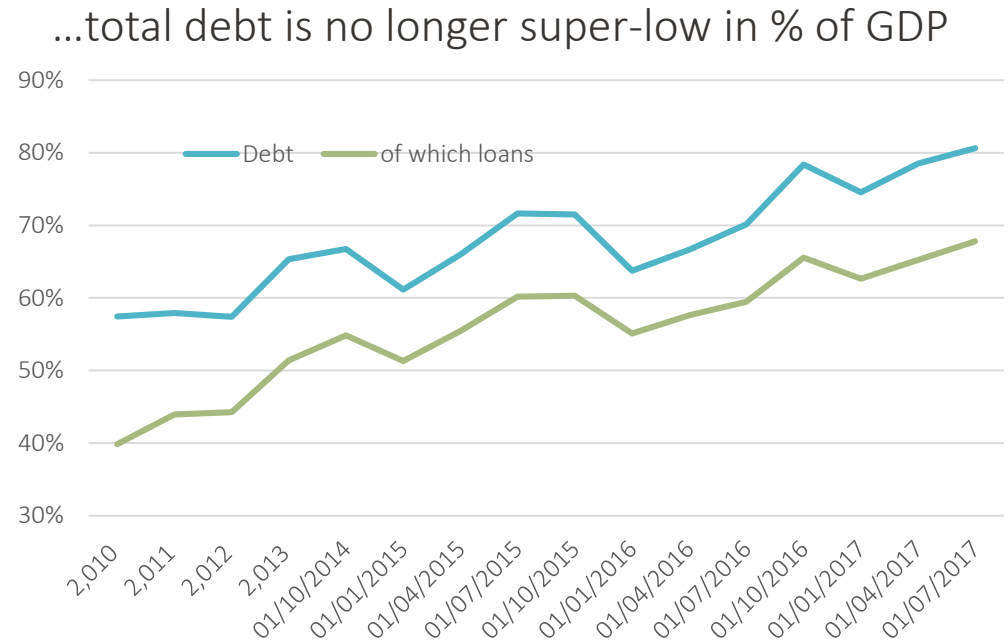
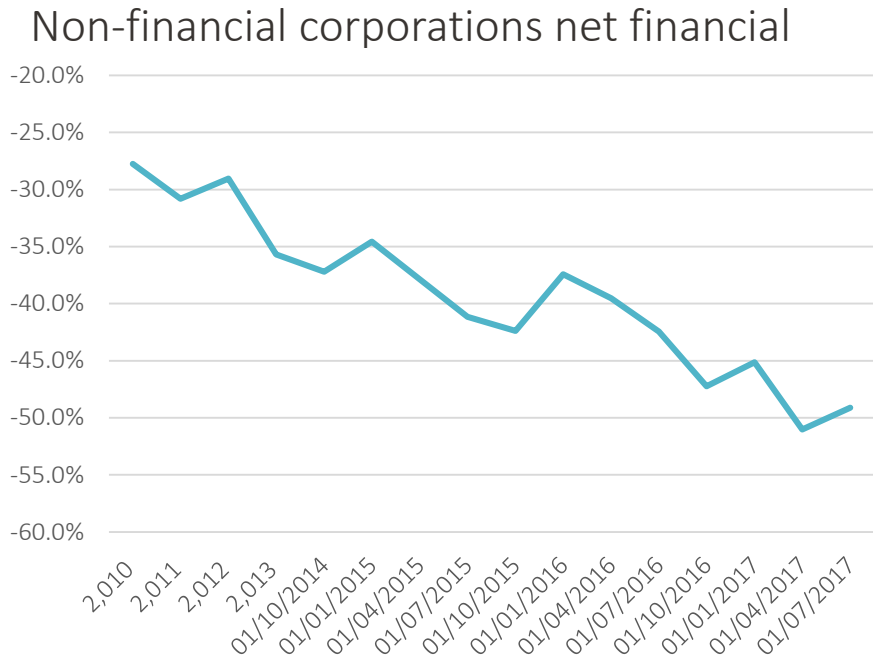


For our debt servicing costs estimates, we assume an average down-payment of 25% (in accordance with the latest regulations), 20-year mortgages, average mortgage interest rates in TRY, and the average price of a small (50sqm) apartment outside the center of a 1M+ Turkish city (excluding Istanbul). For the 2018 forecasting, we estimated the change in mortgage rates deriving the difference with Central Bank key rates tightening during the year, which we expect will lead to average mortgage rates up to 13% at the end of 2018. Finally, we assumed yearly average sqm prices growth of 11%, consistent with the past 3 years. Furthermore, we expect nominal salaries to grow at an average rate of 13% in 2018E.

Sources: Macrobond, CEIC, ADA Economics



# NFCs' balance sheets brewing problems



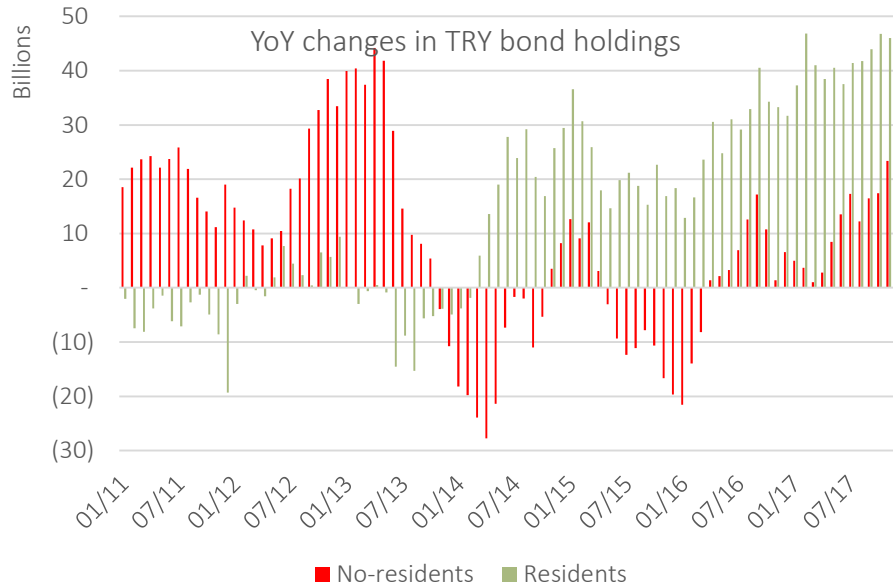
NFCs balance sheets are deteriorating despite the strong growth!

This suggests that either leverage is not yielding enough assets or assets are being moved elsewhere

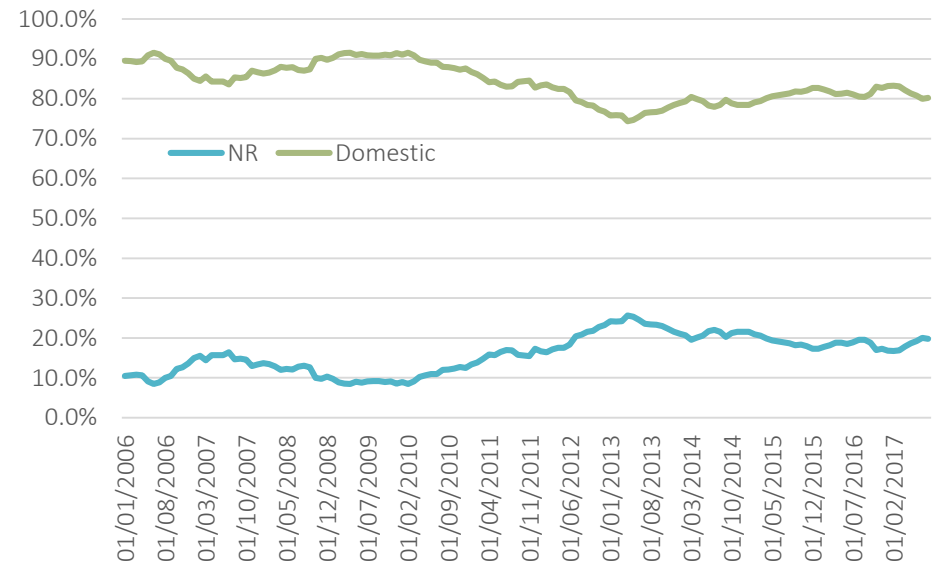
Either way this is going to be a problem when the economic slowdown materialises

# Foreign positioning in the bond market

## YoY changes in local bond holdings



## ...shares of total holdings



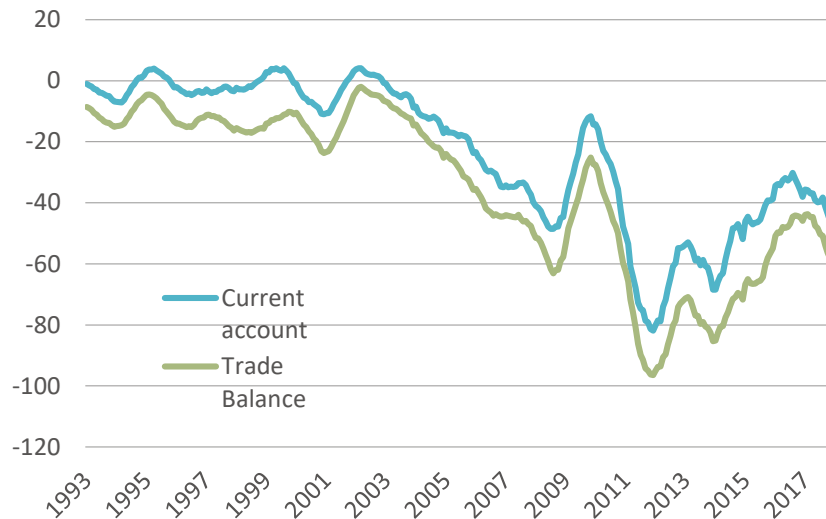
Short term rally is over in terms of new non-resident bond holdings

Bond yields attractive in a world of low interest rates, but TRY still on a depreciation path!

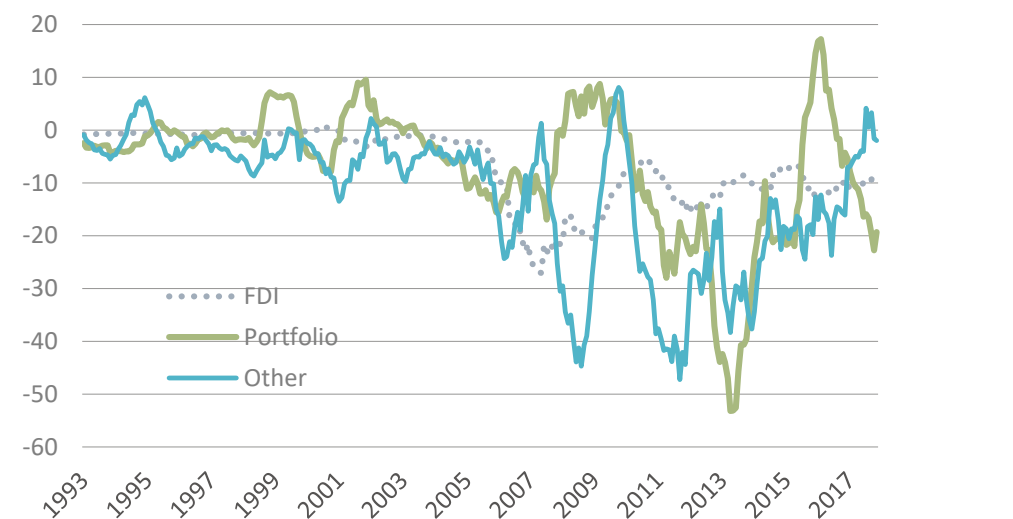


# BoP: TRY weakening trend has more to go

Current account deficit: weak TRY is helping!



Watch out for the funding! Other investment is key



Weak TRY & strong exports are helping, but a meaningful shortfall remains

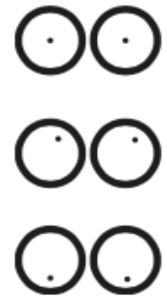
Financing is scarce

In the past portfolio outflows were offset by large FDI – but maybe this time is different?

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