
HELPING YOU PLAN FOR A CHANGING GLOBAL ECONOMY.

We aim to deliver state-of-the-art macroeconomic research to improve the performance of companies.

COUNTRY MONITORING.

TURKEY: IS THE LIRA WEAKENING?

ALESSIO CHIESA
research@adaeconomics.com

THIS PAGE HAS BEEN LEFT BLANK FOR YOUR CONVENIENCE TO TAKE NOTE.

OUR HIGHLIGHTS.

GDP.

- 6. Key forecasts
- 7. GDP growth
- 8. Inflation

BUSINESS CYCLE.

- 9. Production
- 11. Trade
- 12. Balance of Trade

- 13. Labour Market
- 15. Competitiveness
- 18. Consumption

LONG-TERM STRUCTURAL CONSIDERATIONS.

- 19. Indebtedness
- 21. Housing market
- 23. Balance of payments

- 24. Borrowing costs
- 25. Bond market

POLITICS.

DISCLAIMER.

OUR HIGHLIGHTS.

| | Latest developments | Long term considerations | Relevant pages |
|--|---|--|-----------------|
| Economic activity | GDP growth at around 6% this year, but emerging softening signals | Weaker growth likely in 2019, Turkey's potential growth is probably around 3% | 5 to 7, 9 to 20 |
| Inflation/ industrial pricing power | Inflation at around 9% this year | Depreciation outlook implies upside risks to inflation | 6, 8, 18 |
| Exchange rate | Strong signals that depreciation will continue, up to 4.5 in 2018 | We expect the lira to weaken to 5 / USD in 2019, with upside risks | 6, 12, 23 |
| Borrowing costs | Rising, mortgage rate at 15% | Interest rates are high given recent history and regional peers, but lower borrowing costs would necessitate slower growth | 6, 22, 24 |
| Housing market | Prices are high in nominal terms, mortgage demand softening | Affordability of mortgages is deteriorating | 21, 22 |

Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

OUR HIGHLIGHTS.

- On April 9th, 2018 the Turkish government announced a new project-based \$34 billion (TRY 135 bn) package aiming at decreasing the unemployment rate and reduce the widening current account deficit. Consequently, 19 companies will receive incentives for 23 projects (primarily in manufacturing, for it is expected effects of reducing CA deficit), which are projected to create 35000 new jobs directly and 134000 jobs indistinctly, according to the Turkish MoF.
- Examples of incentives offered:
 - Customs and VAT tax exemptions
 - Corporate tax reduction up to 200% of investment amount
 - Interest expense support or grants for investment financing
 - 50% support on energy costs for up to 10 years
 - Support of up to 2000% of gross min wage on qualified personnel, up to 5 years
 - Equity support for up 49% of investments, provided that the stake will be offered to public or for sale within 10 years
 - Public purchase agreements and infrastructure support

Involved companies (listed in bold): Ivi Medica, Assan,Atayurt,BMC (4 projects), CFS, **Dow Aksa**, Ekore,Ersan, **SASA**, pek Mobilya, Most Makine, Siirt Bakır, Metcap Enerji, TUSA , Oyak Renault, Yıldız Metalurji, **Vestel**, Süta , Tosyalı.

Sources: **MACROBOND, CEIC, ADA ECONOMICS LTD.**

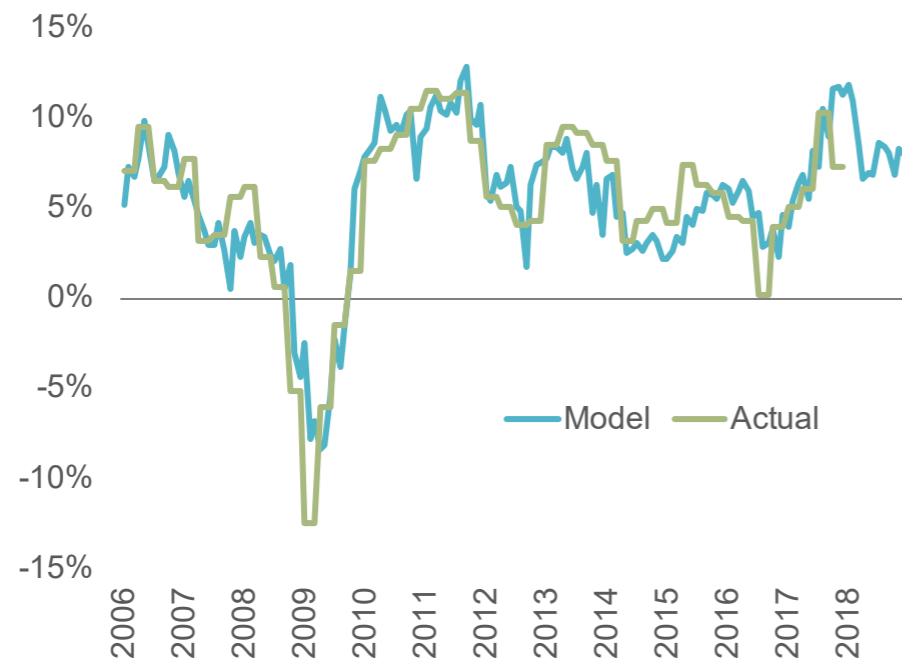
KEY FORECASTS.

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Real GDP growth (%) | 8.5% | 5.2% | 6.1% | 3.2% | 7.4% | 6.5% | 5.1% |
| Households | 7.9% | 3.0% | 5.4% | 3.7% | 6.1% | 7.3% | 5.0% |
| Government | 8.0% | 3.1% | 3.9% | 9.5% | 5.0% | 7.3% | 11.1% |
| Investment | 13.8% | 5.1% | 9.3% | 2.2% | 7.3% | 6.5% | 5.2% |
| Exports | 1.1% | 8.2% | 4.3% | -1.9% | 12.0% | 8.8% | 5.3% |
| Imports | 8.0% | -0.4% | 1.7% | 3.7% | 10.3% | 10.4% | 8.8% |
| Nominal GDP (USD bn) | 951 | 934 | 860 | 864 | 822 | 794 | 811 |
| TRY per USD | 2.1 | 2.3 | 2.9 | 3.5 | 3.8 | 4.5 | 5.0 |
| CPI, tcmb | 7.4% | 8.2% | 8.8% | 8.5% | 11.9% | 9% | 11% |
| Gross external debt (USD bn) | 374 | 401 | 403 | 416 | 438 | 456 | 476 |
| FX reserves (USD bn) | 107 | 108 | 100 | 96 | 88 | 82 | 75 |
| Unemployment rate | 9.0% | 9.9% | 10.3% | 10.9% | 10.9% | 10.5% | 11.5% |
| Wage growth (%) | 14% | 16% | 14% | 16% | 13% | 14% | 14% |
| Mortgage rates (new business) | 9.7% | 11.9% | 12.3% | 13.3% | 12.1% | 14.1% | 15.0% |
| Fiscal balance (as % of GDP) | -1.2% | -1.4% | -1.2% | -1.6% | -2.0% | -2.1% | -2.6% |
| Public debt (as % of GDP) | 34% | 32% | 31% | 31% | 31% | 33% | 35% |

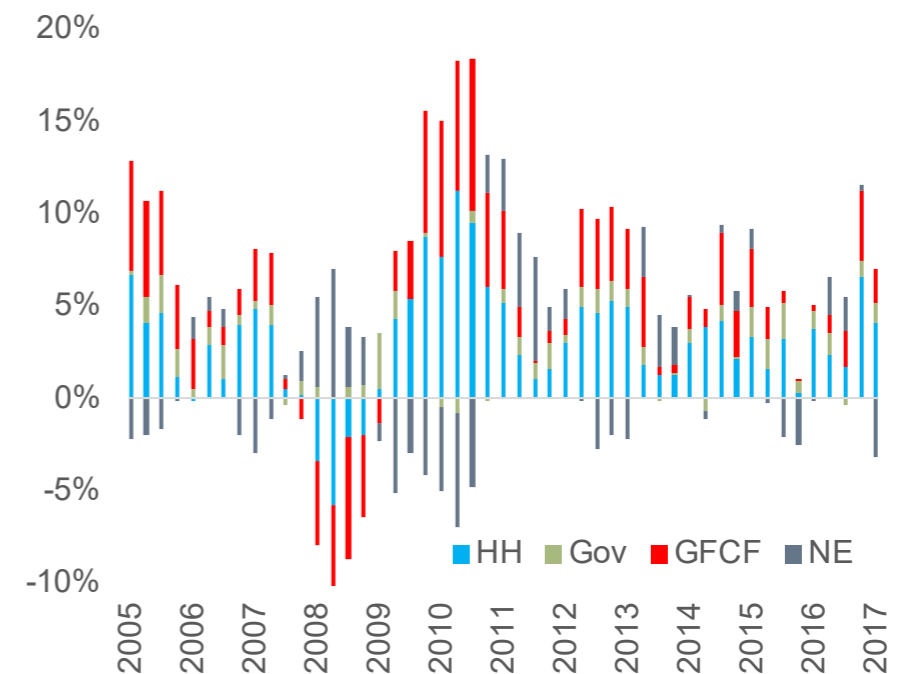
Sources: : MACROBOND, CEIC, ADA ECONOMICS LTD.

GDP GROWTH.

Nominal GDP growth & projections.



Contributions by key component to YoY growth.

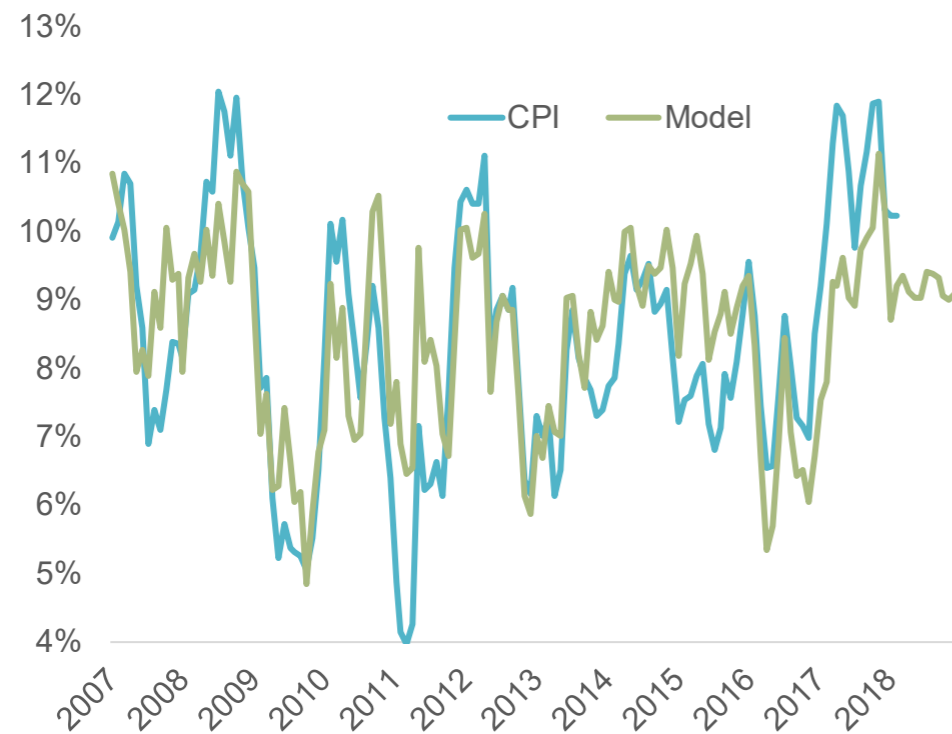


The econometric model to forecast YoY real growth implements as explanatory variables unemployment, growth in total credits, growth in lagged exports, and lagged consumer confidence.

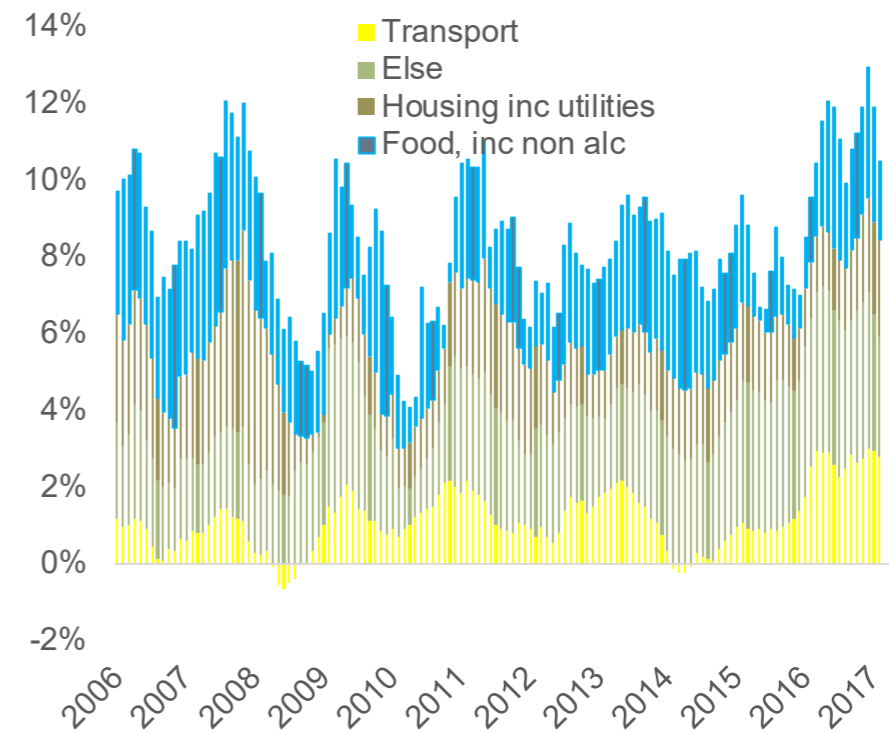
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

INFLATION.

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 LTD.

OVERVIEW OF THE BUSINESS CYCLE.

Order Expectations.



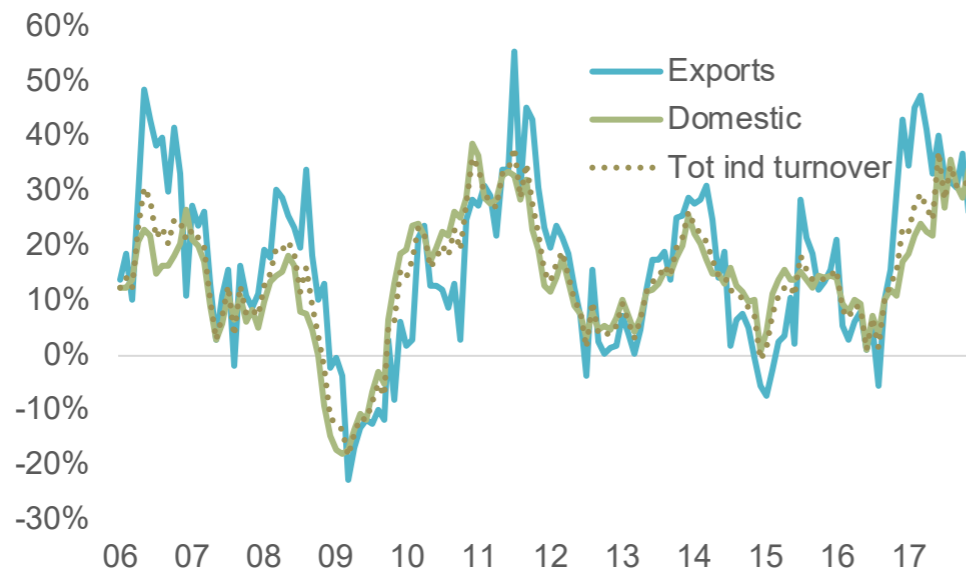
Industrial sentiment and export expectations.



Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

PRODUCTION: CURRENT STATUS & OUTLOOK.

Industrial turnover YoY.



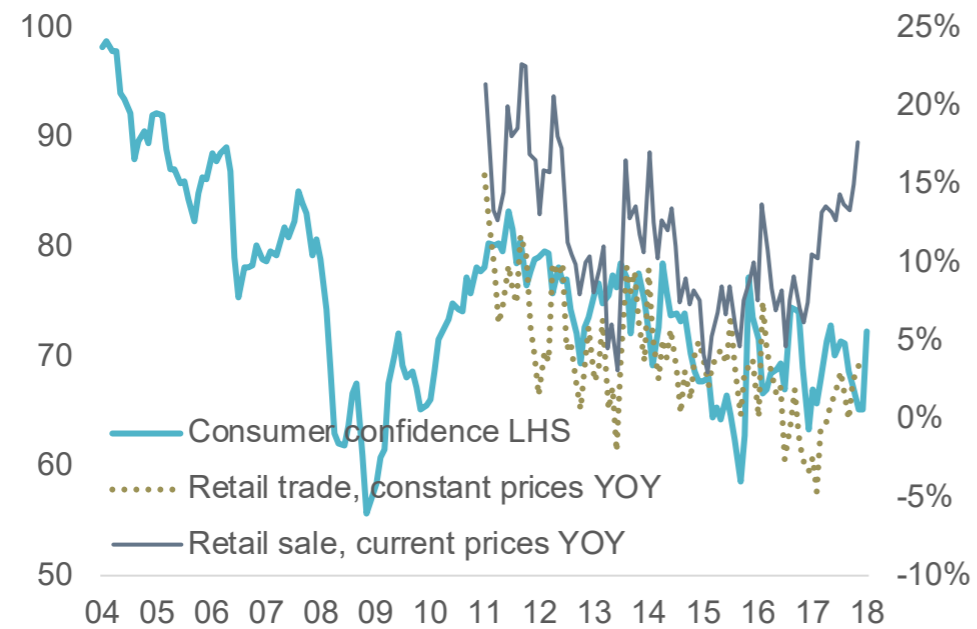
Manufacturing capacity utilisation.



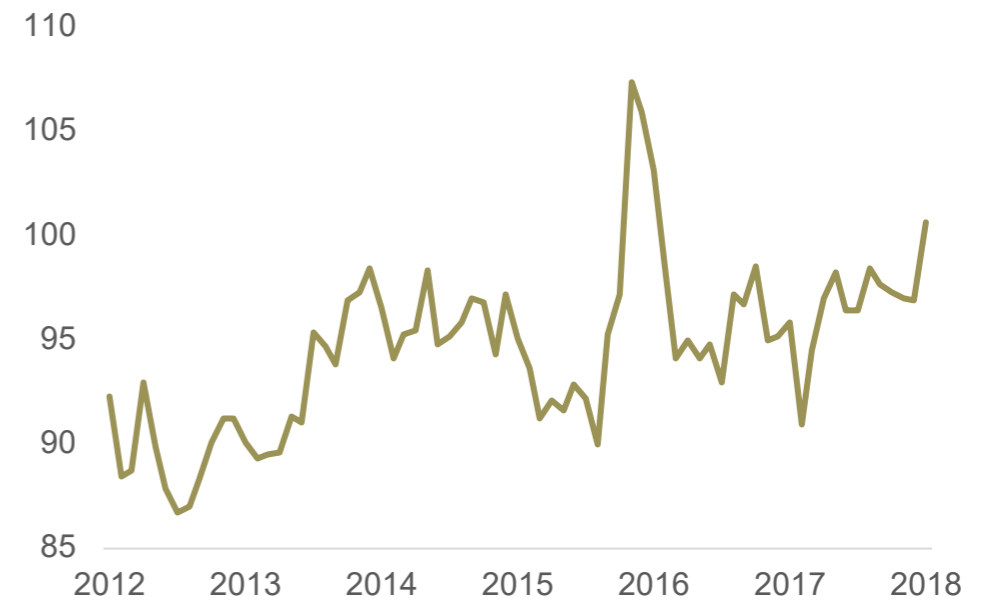
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

TRADE.

Retail sales growth fairly weak in constant prices.

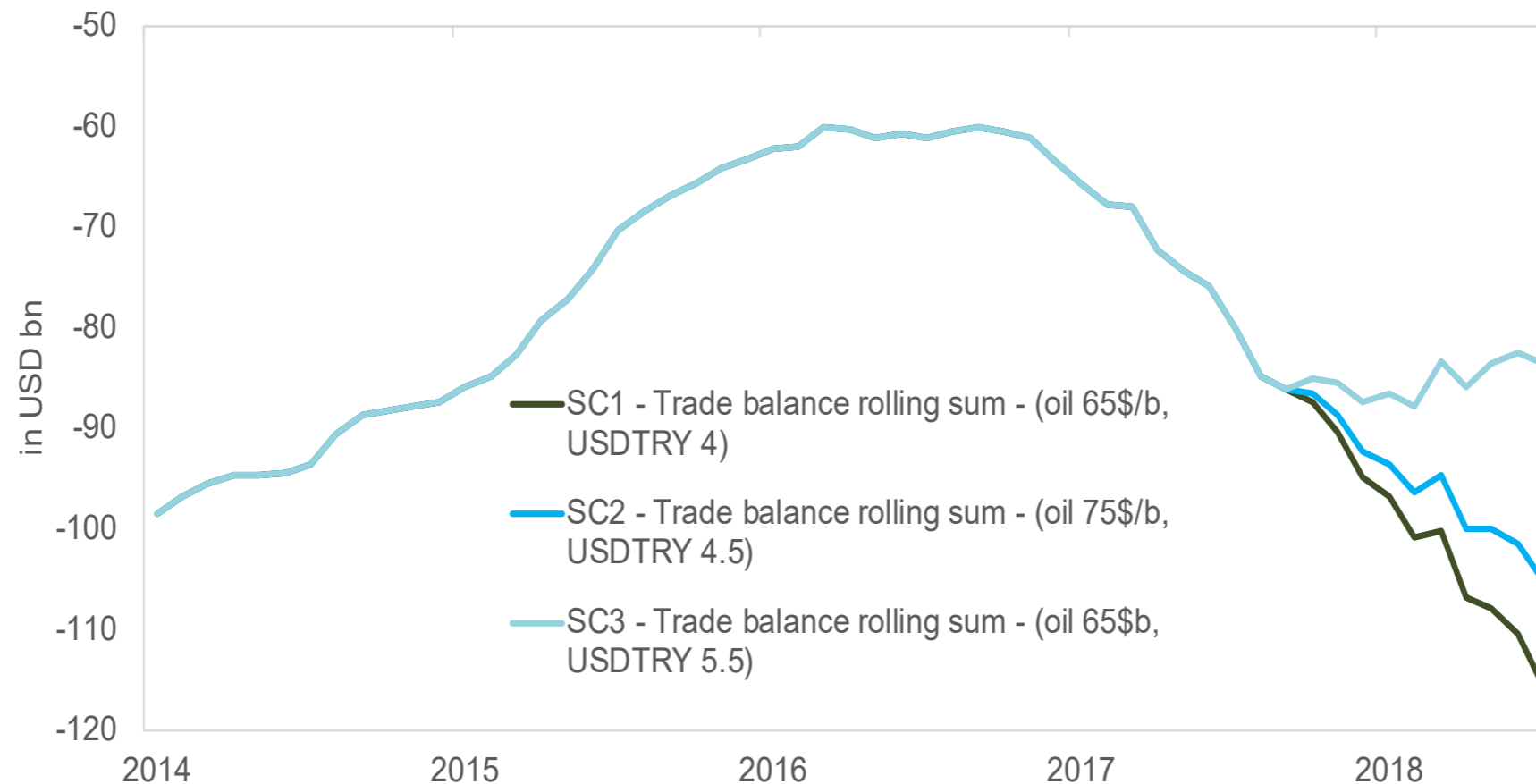


Wage expectations going up.



Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

BALANCE OF TRADE.

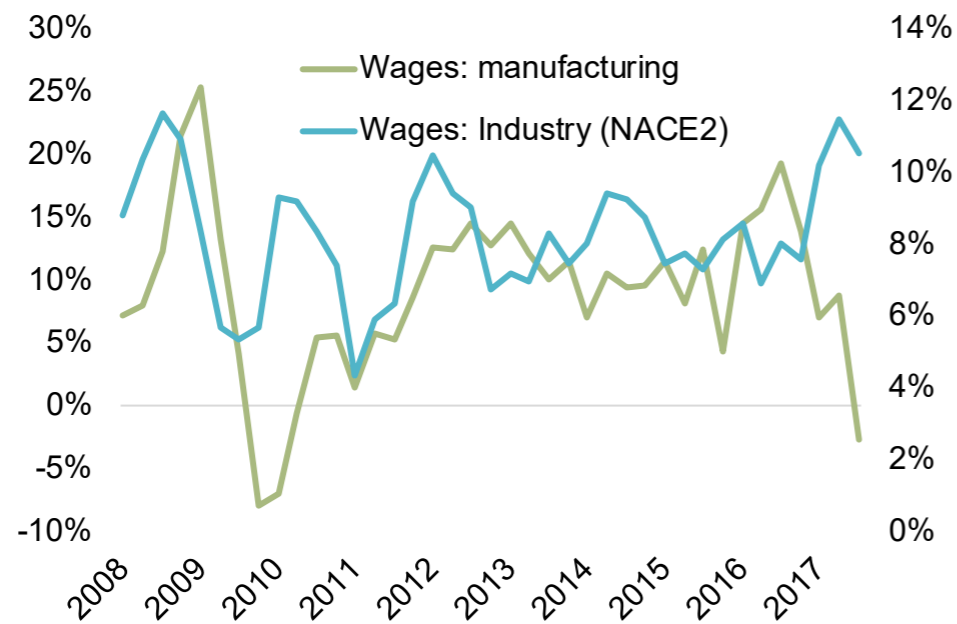


This model to forecast Trade Balance, separately forecasts imports and exports before estimating trade deficit. The separate models integrate as key variables exchange rate, oil prices lagged services confidence, lagged M2, lagged leading cyclical indicator, and lagged interbank rate. Scenario 1 assumes a TRYUSD exchange rate of 4 and Brent price of 75\$ 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 30% (Scenario 1) to 43% (Scenario 2). The outlined Scenario 3 instead shows how, all else equal, the competitive gains of the weak lira start affecting trade balance positively after USDTRY is above 5.5.

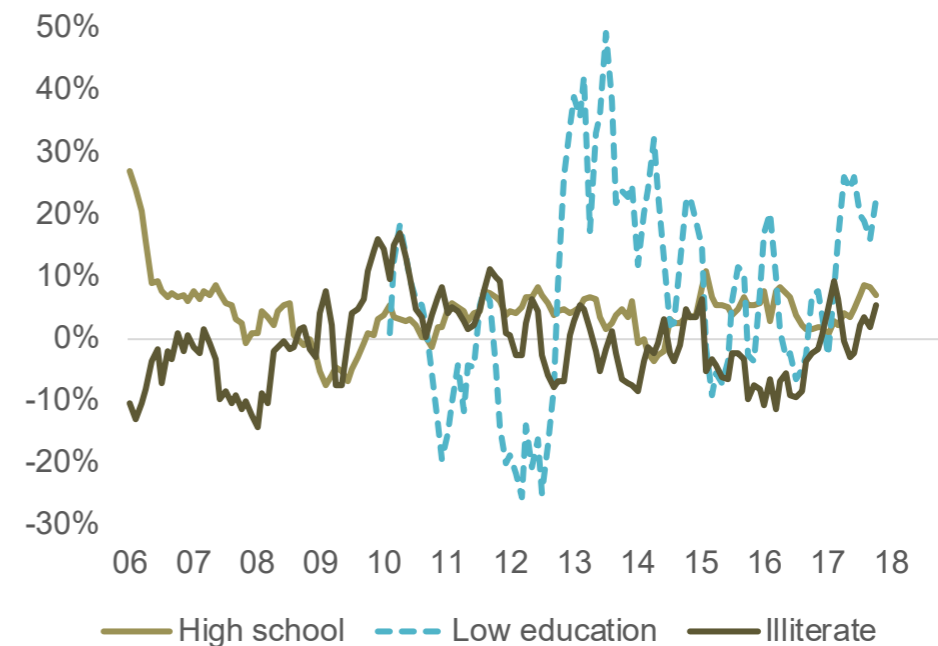
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

LABOUR MARKET.

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 LTD.

LABOUR MARKET.

Gross annual wages, USD.

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017E |
|------------------------------|-------|-------|-------|-------|-------|-------|
| Czech Republic | 9248 | 8689 | 8513 | 10586 | 11097 | 11453 |
| Hungary | 7156 | 7002 | 7010 | 8692 | 9196 | 10067 |
| Poland | 8269 | 8217 | 8626 | 10670 | 10661 | 11203 |
| Romania | 4444 | 4574 | 4834 | 6259 | 6997 | 7603 |
| Russia | 10360 | 11361 | 10202 | 6698 | 6575 | 8052 |
| Turkey (high skilled) | 8642 | 8968 | 9664 | 10420 | 10471 | 9576 |
| Turkey (low skilled) | 6143 | 6294 | 6765 | 6991 | 6239 | 5184 |

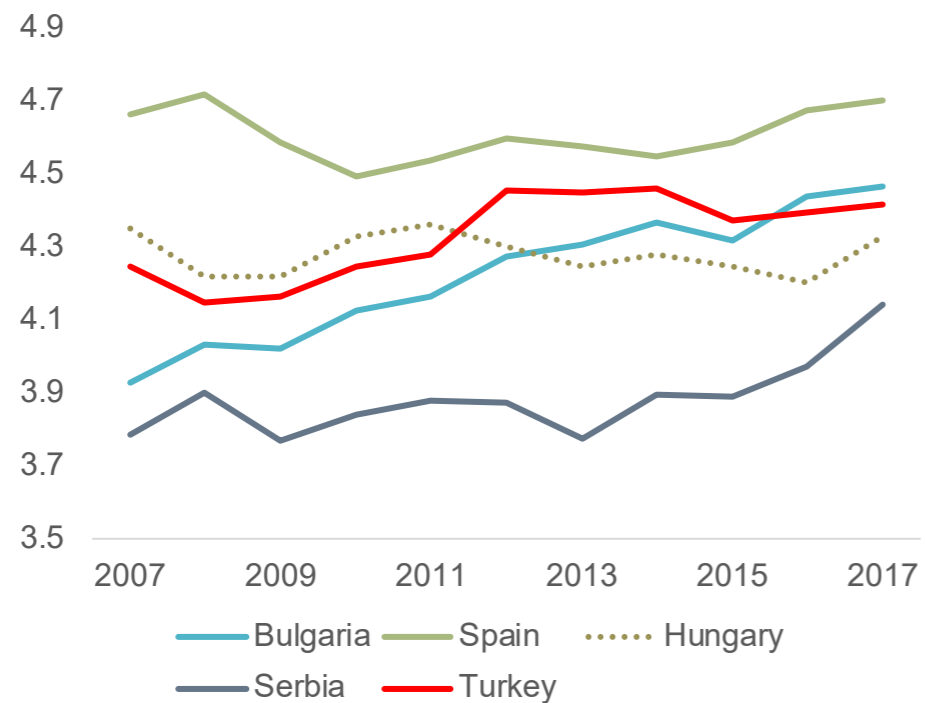
Gross annual wages, USD, Turkey low skilled equal 100.

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017E |
|------------------------------|------|------|------|------|------|-------|
| Czech Republic | 151 | 138 | 126 | 151 | 178 | 221 |
| Hungary | 116 | 111 | 104 | 124 | 147 | 194 |
| Poland | 135 | 131 | 128 | 153 | 171 | 216 |
| Romania | 72 | 73 | 71 | 90 | 112 | 147 |
| Russia | 169 | 181 | 151 | 96 | 105 | 155 |
| Turkey (high skilled) | 141 | 142 | 143 | 149 | 168 | 185 |
| Turkey (low skilled) | 100 | 100 | 100 | 100 | 100 | 100 |

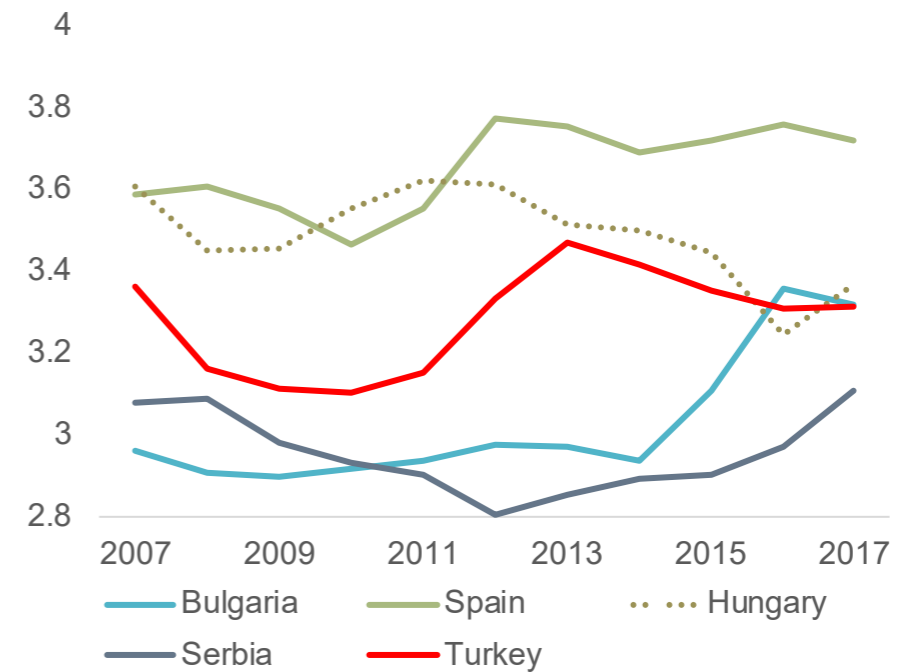
Sources: NATIONAL STATISTICAL OFFICES, CEIC, WAGE INDICATOR FOUNDATION, ADA ECONOMICS LTD IN ASSOCIATION WITH WOOD RESEARCH.

LONG-TERM STRUCTURAL CONSIDERATIONS.

Global Competitiveness Index.



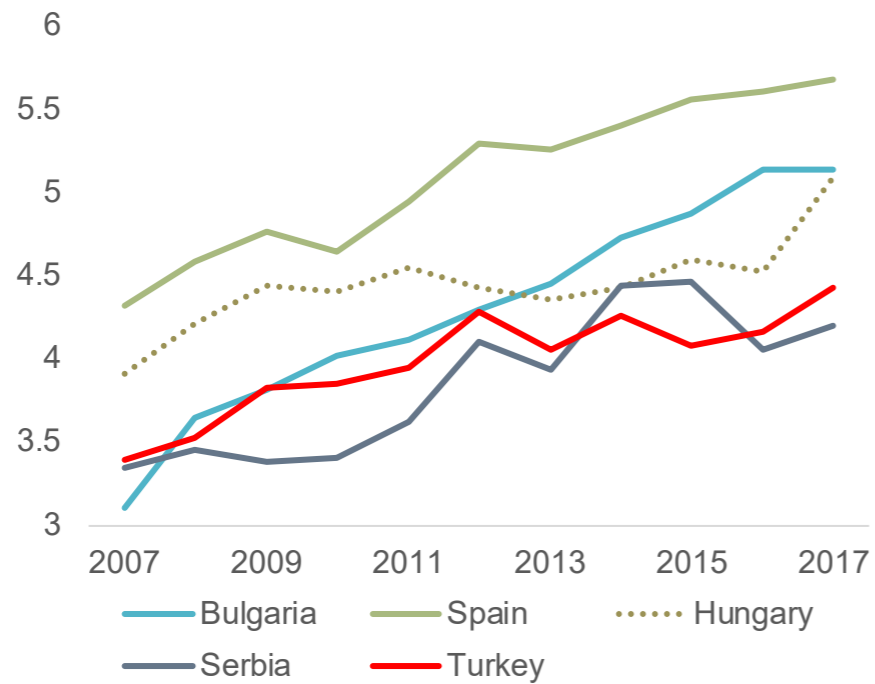
Innovation.



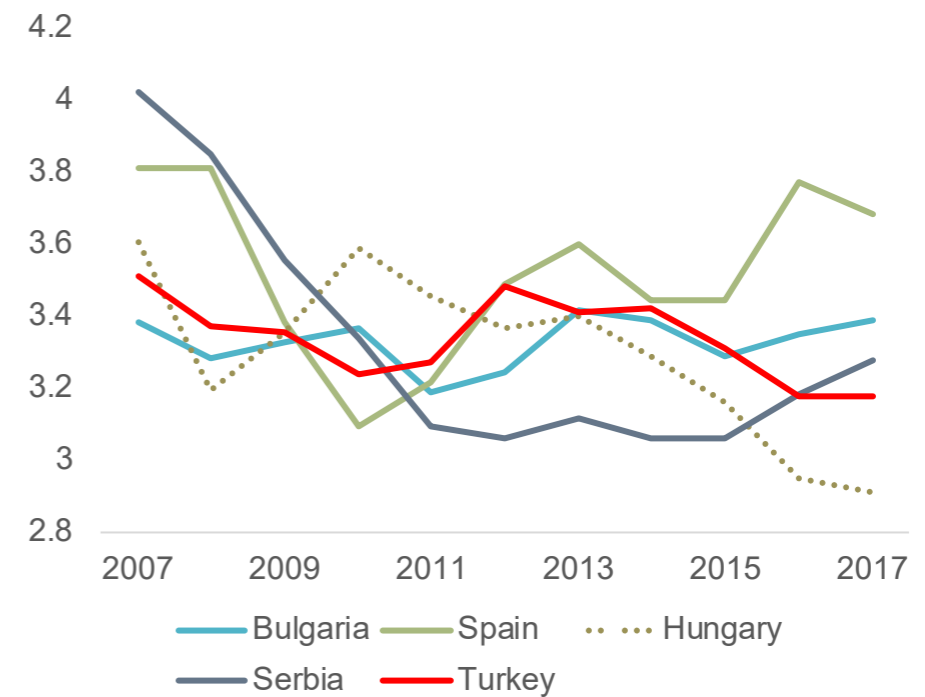
Sources: MACROBOND, WEF, CEIC, ADA ECONOMICS LTD.

COMPETITIVENESS.

Technological readiness.



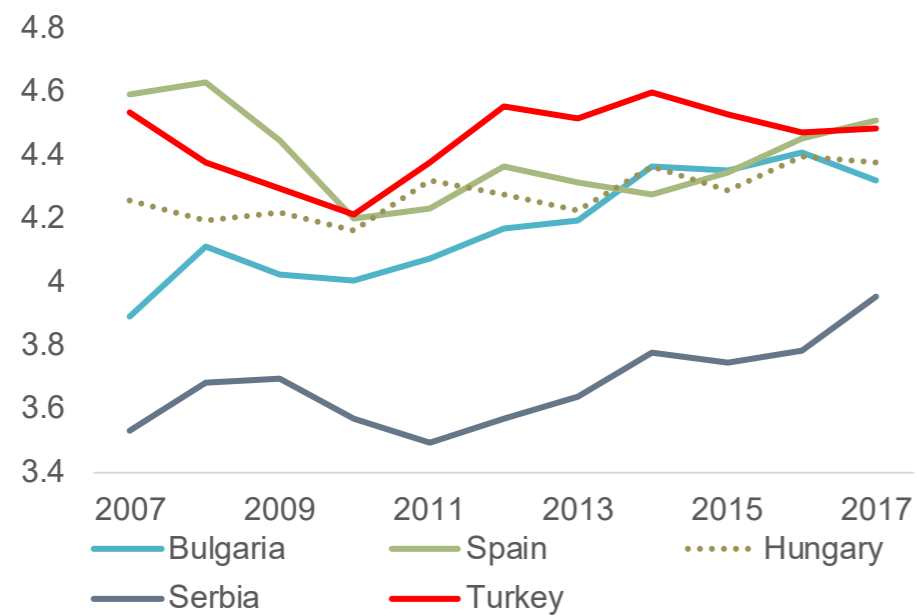
Quality of the education system.



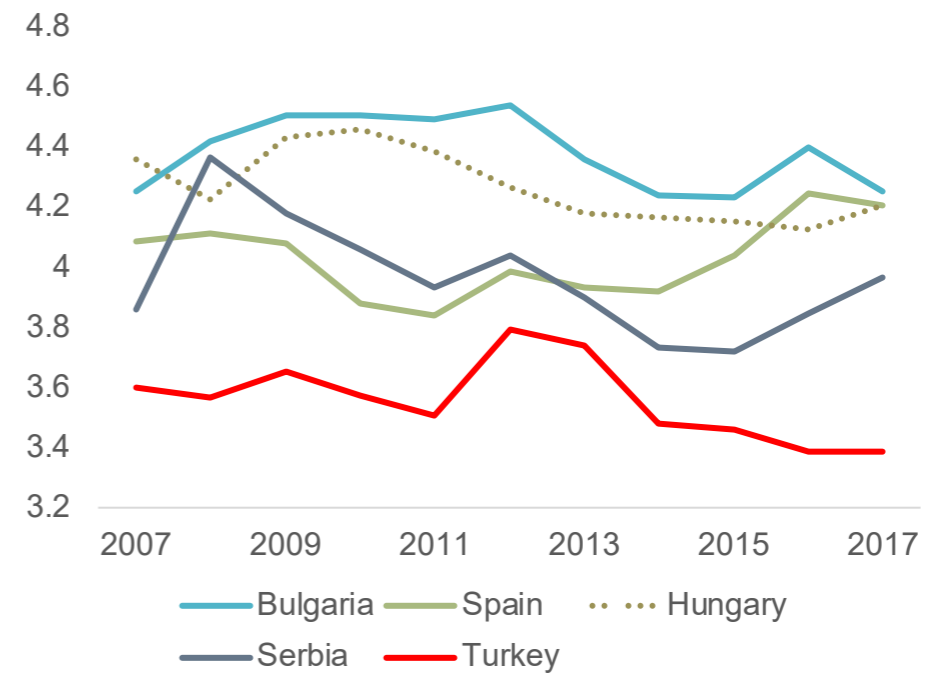
Sources: WEF, ADA ECONOMICS LTD.

COMPETITIVENESS.

Goods market efficiency.



Labour market efficiency.



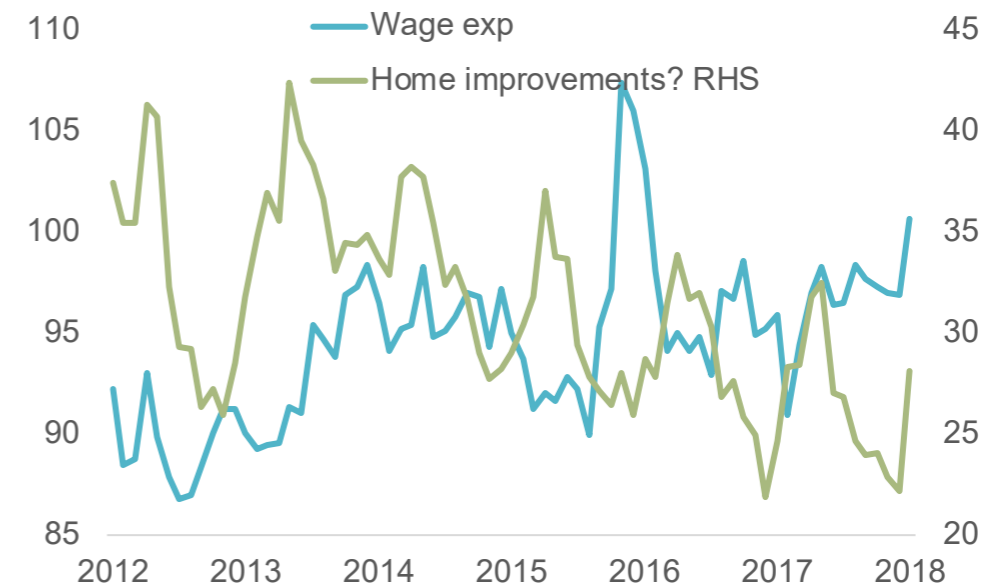
Sources: WEF, ADA ECONOMICS LTD.

CONSUMPTION.

**Falling CPI concerns,
but rising unemployment fears.**



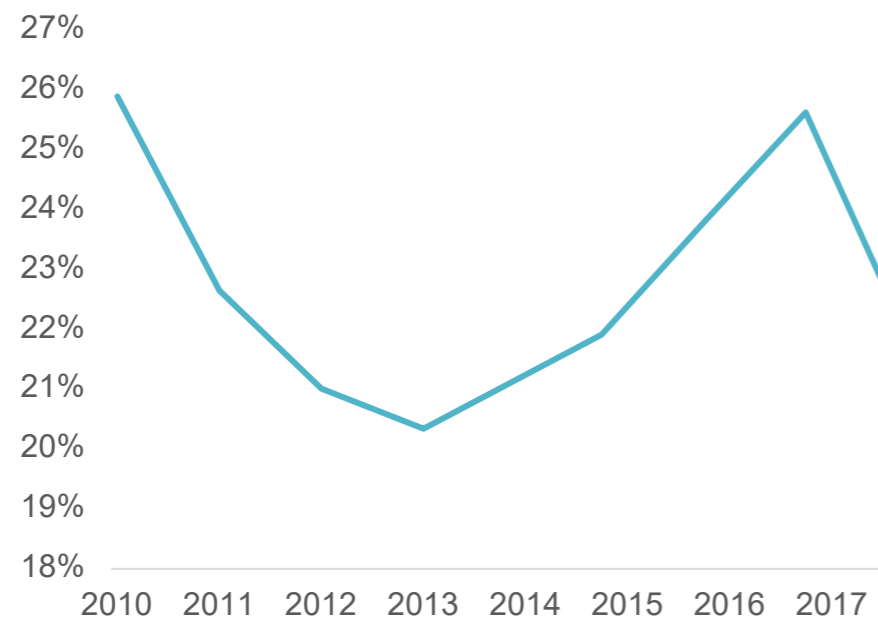
Wage expectations going up.



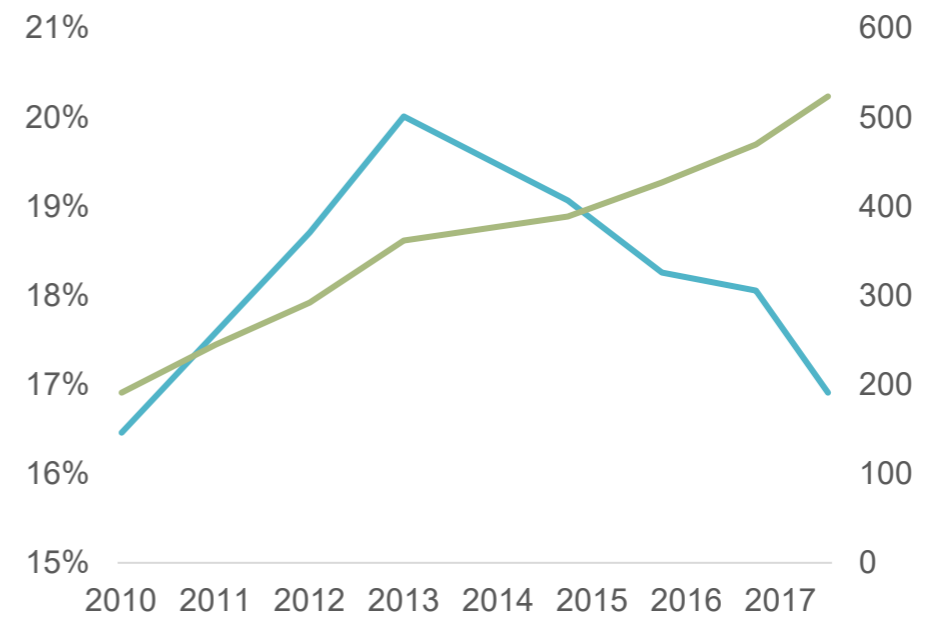
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

INDEBTEDNESS.

Households net financial balance % GDP.



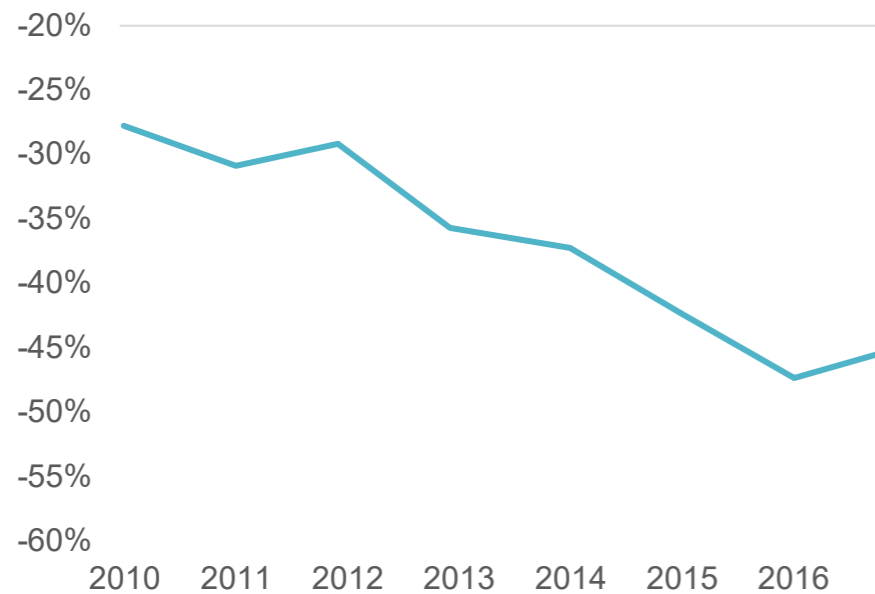
Households total debt over GDP(lha) and level of household total liabilities (TRY bn, rha).



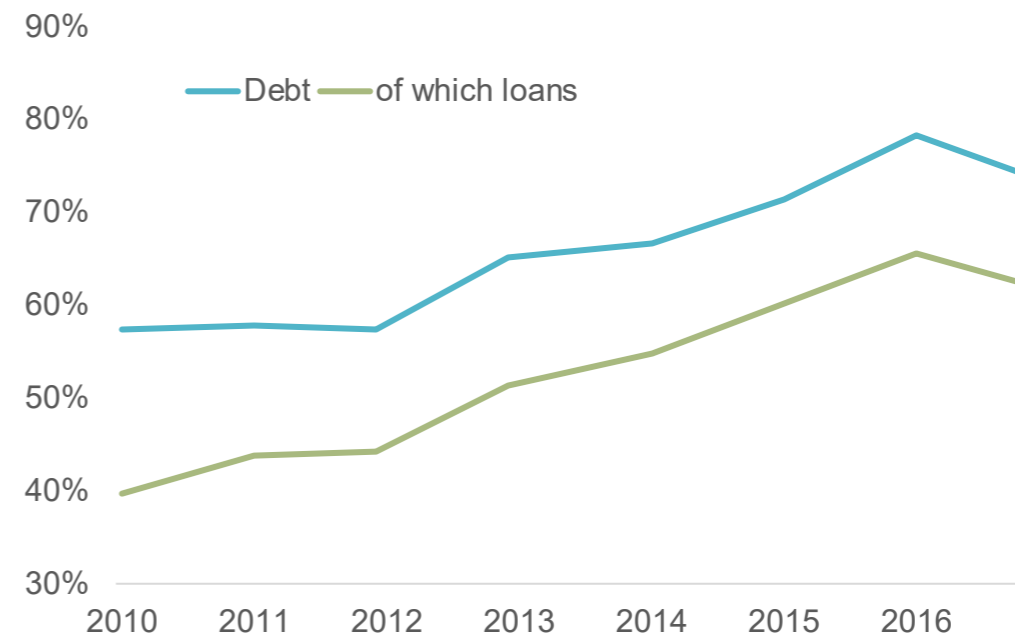
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

INDEBTENESS.

Non-financial corporations net financial balance % GDP.



Total debt is no longer extremely low in % of GDP.

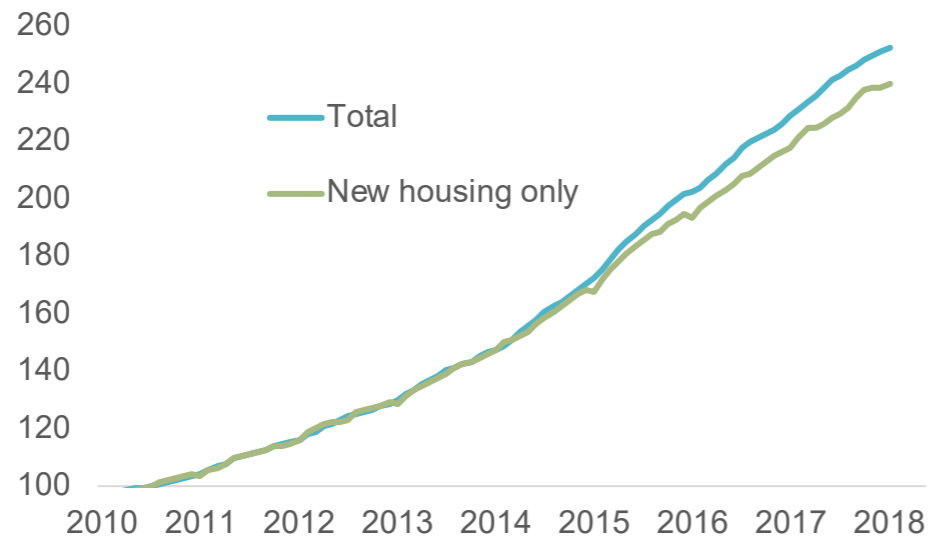


- **NFCs balance sheets are deteriorating despite the strong growth! This suggests that either leverage is not yielding enough assets or assets are being moved elsewhere**

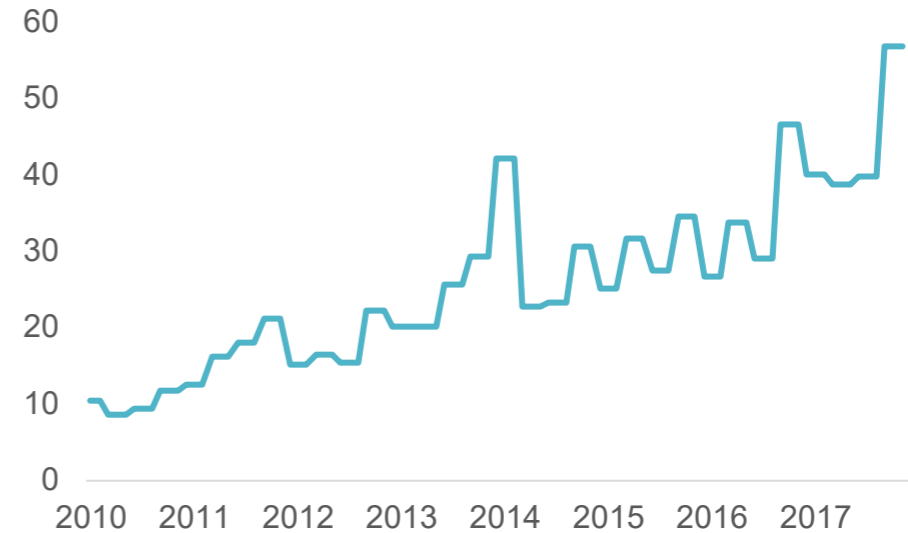
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

HOUSING MARKET.

House prices are very high...



...as much as construction permits!

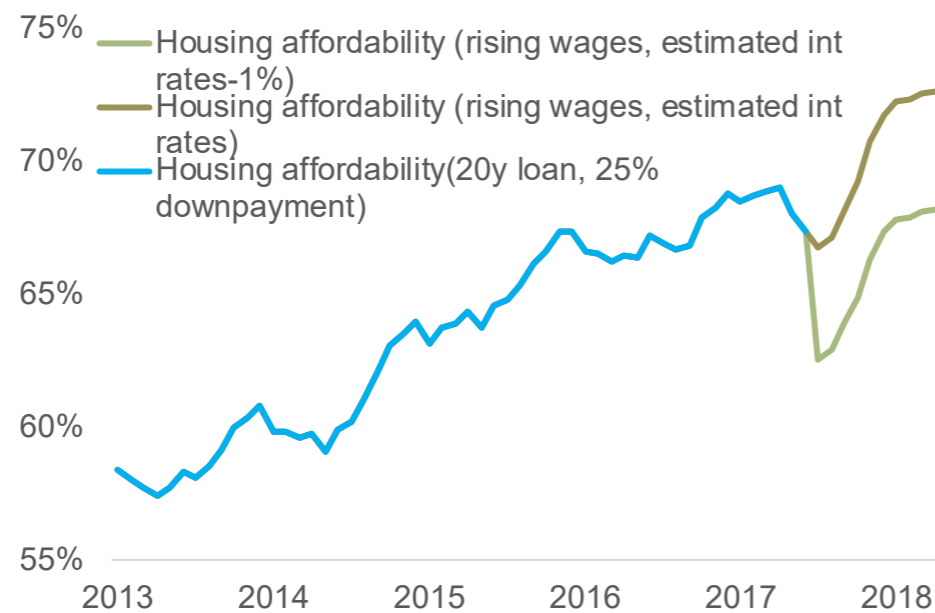


- House prices appear high even given the strong economy
- Momentum in construction remains high

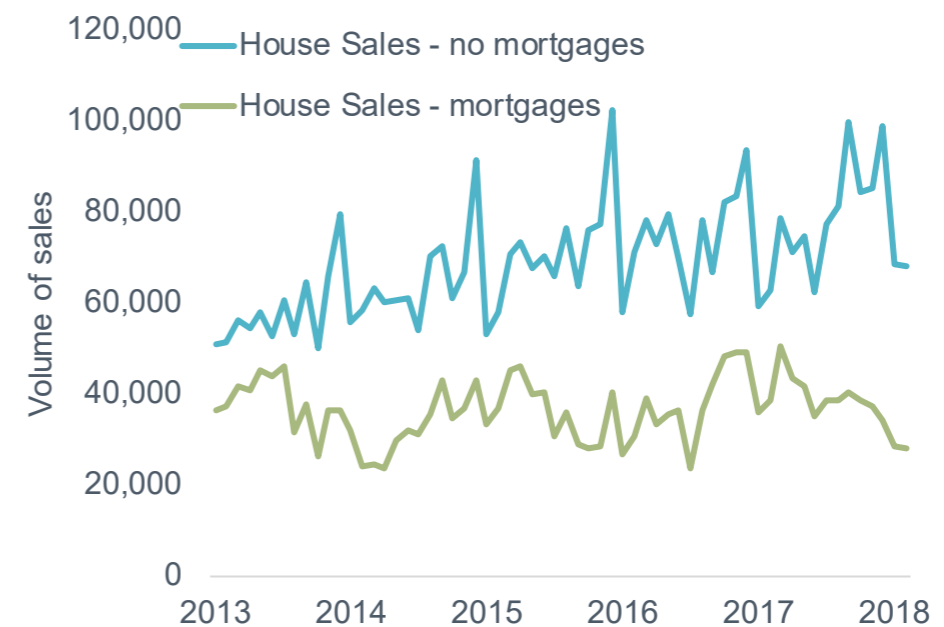
Sources: : MACROBOND, CEIC, ADA ECONOMICS LTD.

HOUSING MARKET.

Higher debt servicing costs in 2018.



Mortgages portion bound to continue decreasing.

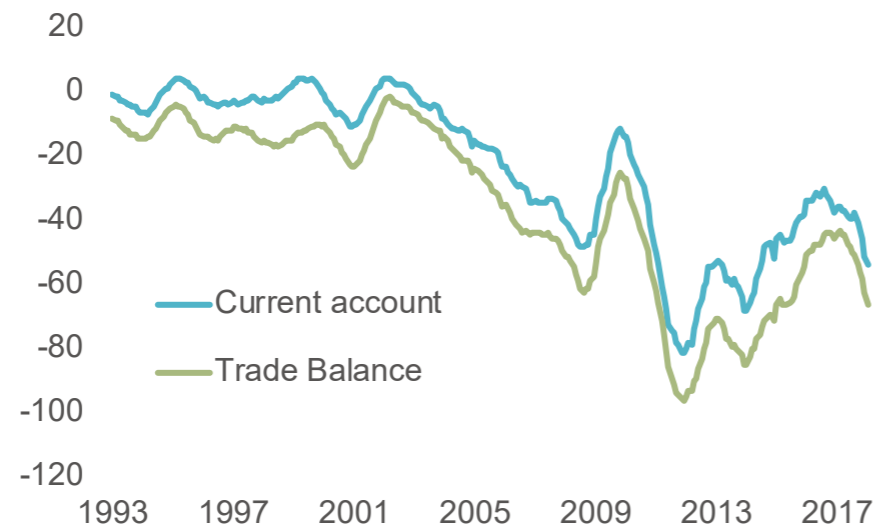


- For our debt servicing costs estimates, we assume an average down-payment of 25% (in accordance with the latest regulations), 20-year mortgages, average mortgage interest rates in TRY, and the average price of a small (50sqm) apartment outside the center of a 1M+ Turkish city (excluding Istanbul). 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.

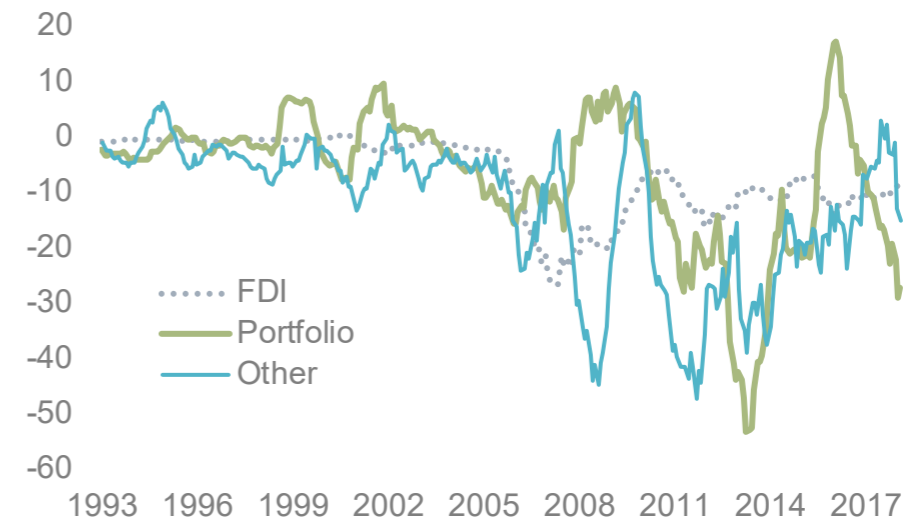
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

BALANCE OF PAYMENTS.

Current account deficit, rolling sum.



Non-performing loans (EUR bn).

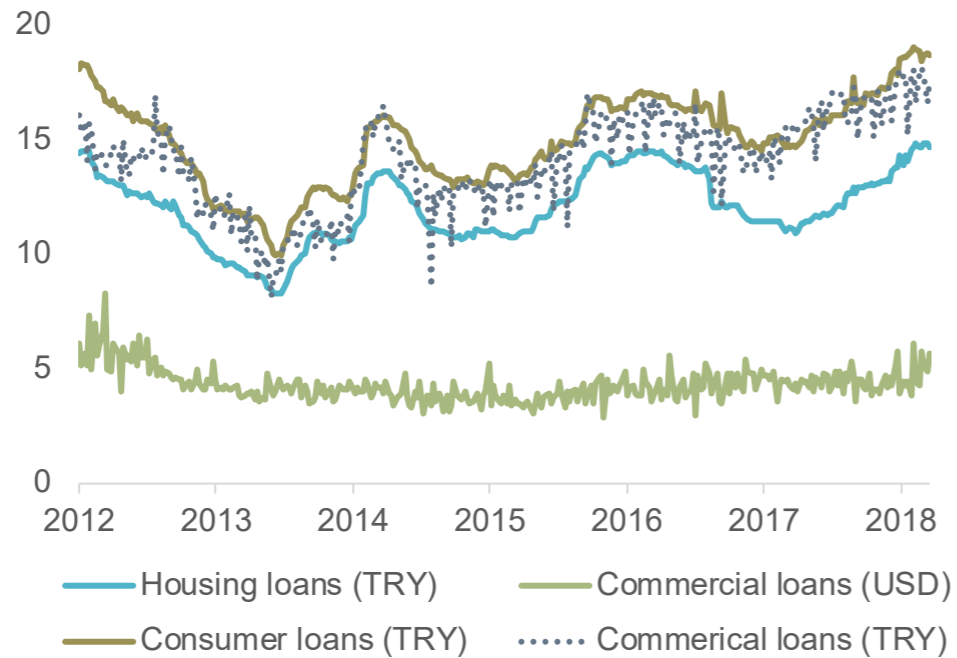


- Exports growth is lagging behind the increase in imports, recording in March respectively a YoY increase of 11.5% and 19.7%. Overall, Current Account deficit widened in February, with the portfolio investments net inflows signaling that Turkey might rely more on financial instruments to finance the deficit, in absence of Foreign Direct Investment.

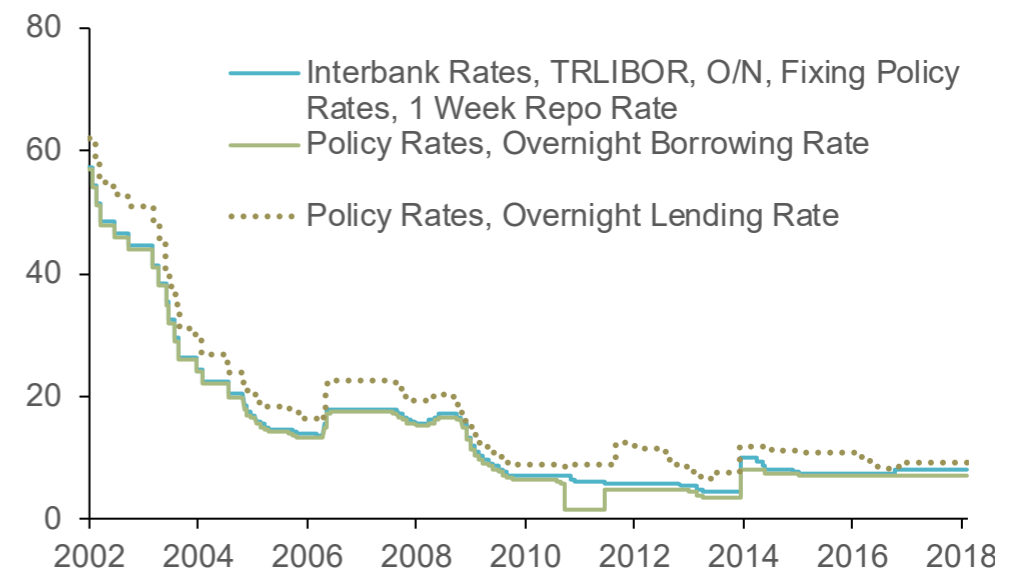
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

BORROWING COSTS.

Retail sales lending rates.



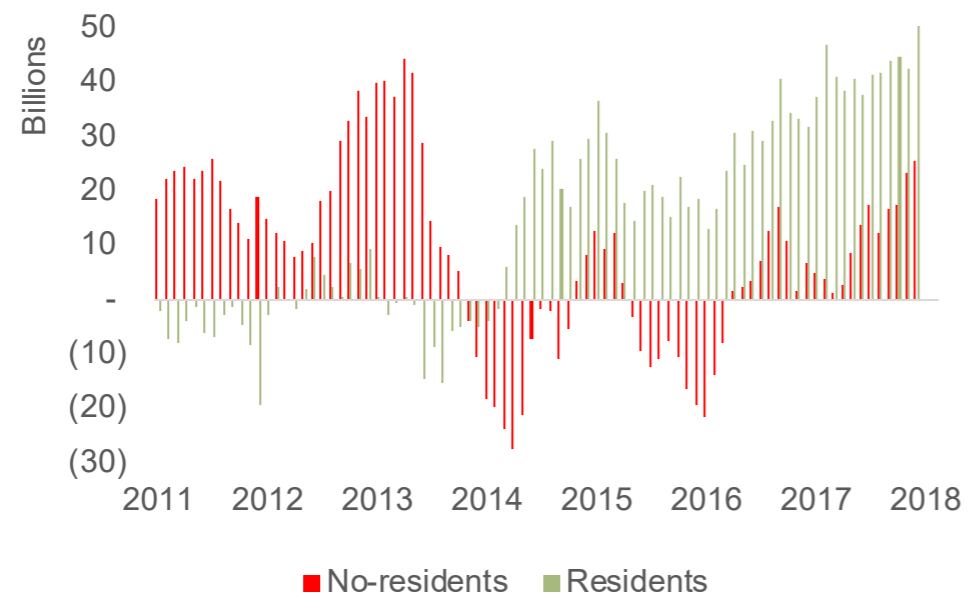
Policy rate corridor.



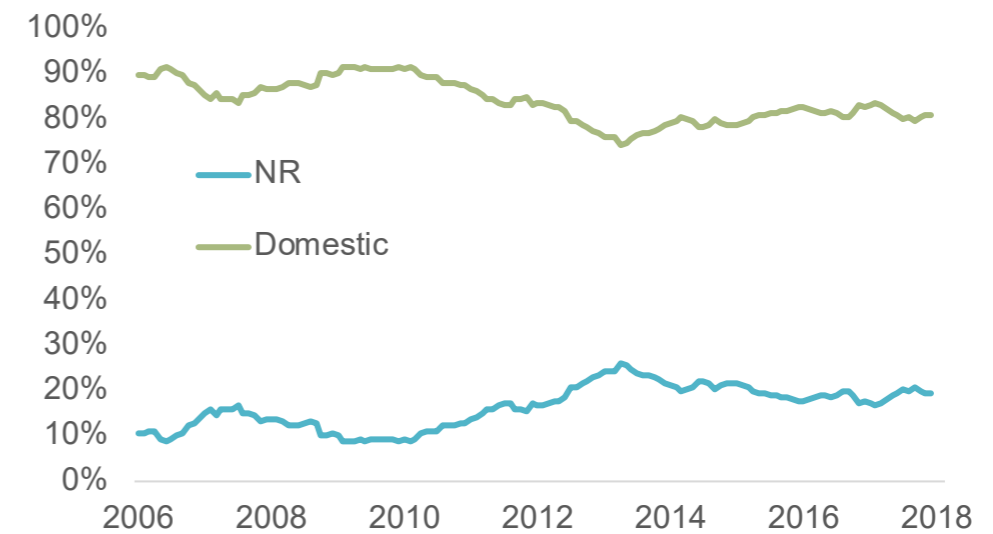
Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

BOND MARKET.

YoY changes in local bond holdings.



Shares of total holdings.

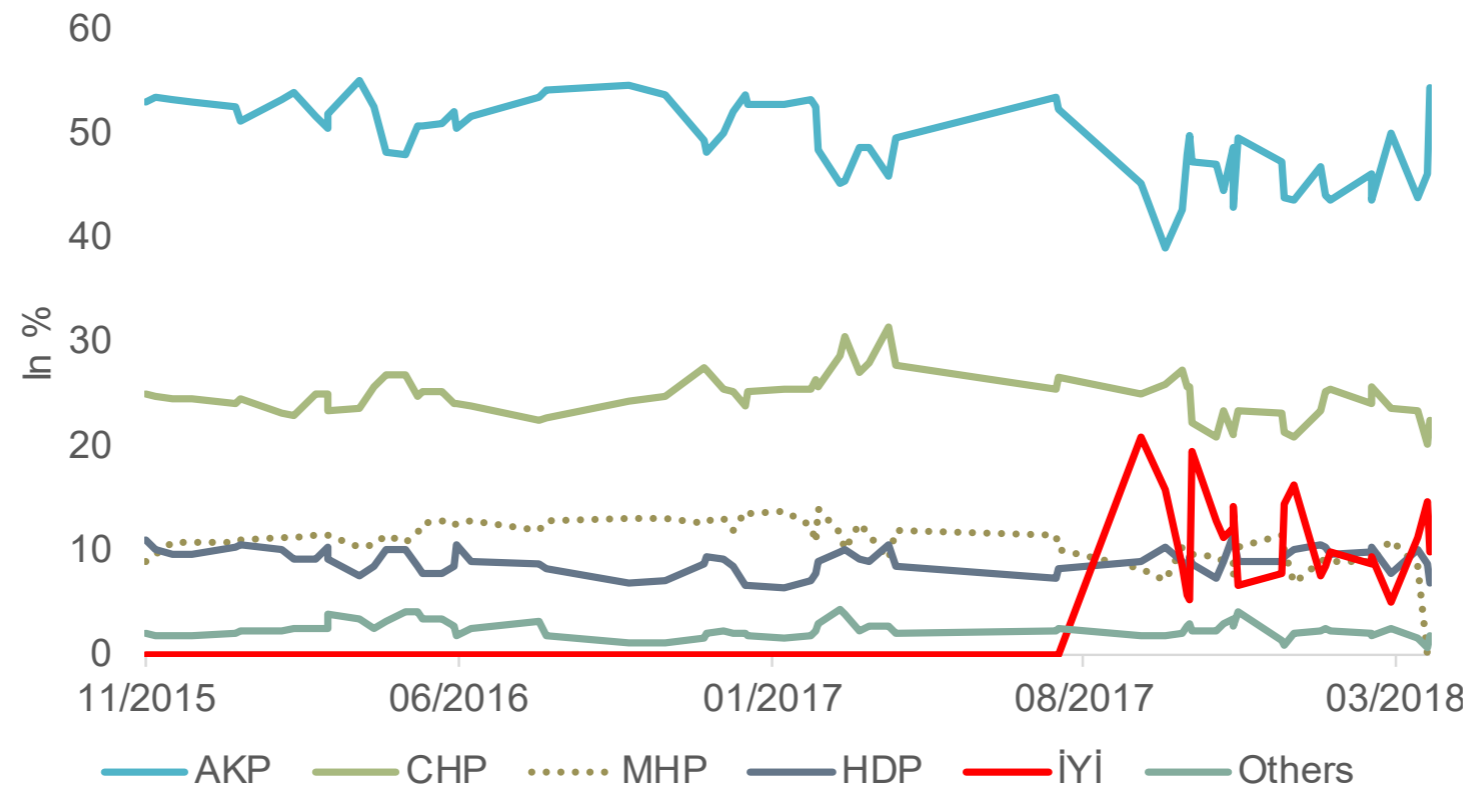


- Short term rally is over in terms of new non-resident bond holdings
- Bond yields attractive in a world of low interest rates, but TRY still on a depreciation path!

Sources: MACROBOND, CEIC, ADA ECONOMICS LTD.

POLITICAL OVERVIEW: ELECTIONS.

Electoral polls.



- The approval of the constitutional reform in a referendum in 2017 changed the system from a parliamentary republic to a presidential system with executive presidency. Elections are planned to be held on 3 November 2019, for both to the President and the parliament (Grand National Assembly). So far, the most likely candidates are Recep Tayyip Erdoğan, the leader of the Justice and Development Party (AKP) now allied with the MHP (nationalist party), Meral Akşener, Leader of the İYİ Party founded on October 25, 2017, Kemal Kılıçdaroğlu, leader of the Republican People's Party (CHP, and Tuna Bekleviç, an independent candidate that established the "No Party" initiative.

Sources: VARIOUS POLLING AGENCIES FROM CUMHURİYET, ADA ECONOMICS LTD.

DISCLAIMER

I/ Copyright 2017 ADA. All rights reserved.

This report may provide information, commentary and discussion of issues relating to the state of the economy and the capital markets. All opinions, projections and estimates constitute the judgment of the author as of the date of the report and are subject to change without notice. ADA is under no obligation to update this report and readers should therefore assume that AD will not update any fact, circumstance or opinion contained in this report.

The content of this report is provided for discussion purposes only. Any forward looking statements or forecasts included in the content are based on assumptions derived from historical results and trends. Actual results may vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision, and no investment decisions should be made based on the content of this report.

This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and particular needs of any specific person. Under no circumstances does any information represent a recommendation to buy or sell securities or any other asset, or otherwise constitute investment advice. Investors should seek financial advice regarding the appropriateness of investing in specific securities or financial instruments and implementing investment strategies discussed or recommended in this report.

This report should not be regarded by recipients as a substitute for the exercise of their own judgment and readers are encouraged to seek independent, third-party research on any companies discussed or impacted by this report.

In accordance with rules established by the U.K. Financial Services Authority, macroeconomic analysis is NOT considered investment research.

Materials prepared by ADA research personnel are based on public information. Facts and views presented in this material have not been reviewed by, and may not reflect information known to, professionals in other business areas of ADA.

To the extent this report discusses any legal proceeding or issues, it has not been prepared as nor is it intended to express any legal conclusion, opinion or advice. Investors should consult their own legal advisers as to issues of law relating to the subject matter of this report. ADA research personnel's knowledge of legal proceedings in which any ADA entity and/or its directors, officers and employees may be plaintiffs, defendants, co—defendants or co—plaintiffs with or involving companies mentioned in this report is based on public information. Facts and views presented in this material that relate to any such proceedings have not been reviewed by, discussed with, and may not reflect information known to, professionals in other business areas of ADA in connection with the legal proceedings or matters relevant to such proceedings.

The information herein (other than disclosure information relating to ADA and its affiliates) was obtained from various sources and while all effort has been made to provide accurate information, ADA does not guarantee its accuracy. This report may contain links to third—party websites. ADA is not responsible for the content of any third—party website or any linked content contained in a third—party website. Content contained on such third—party websites is not part of this report and is not incorporated by reference into this report. The inclusion of a link in this report does not imply any endorsement by or any affiliation with ADA. Any unauthorised use or disclosure is prohibited.

Date: 13 April 2018

ANALYSE. DEBATE. ACT.

TEST US OUT!

Call us to sign up for a free trial, or to join one of our breakfast events.

Stamford Works, Unit 5H
Gillett Street
London, N16 8JH
UK

callmeback@adaeconomics.com
phone: +44 (0) 759 4704 277
www.adaeconomics.com

We are also members of Euro IRP / Eri-c /
Italian Chamber of Commerce of Italy in the UK

#1000REASONSTOUSEADA

   Bloomberg