TACİRLER
INVESTMENT

Turkish Economy

Revisiting 2019 & 2020 forecasts

June 2019

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Economic Growth

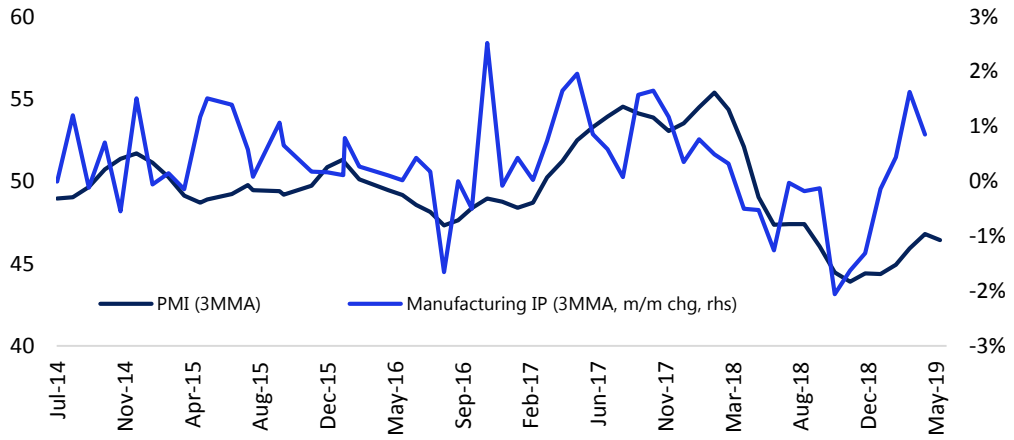
We revise down our 2019 GDP growth to -0.3% from 1.5% y/y

- We now expect the GDP to contract by 0.3% in 2019 vs the previous forecast of 1.5% y/y growth.
- The course of the loan growth has geared up starting from the beginning of the year mainly with the help of the public banks. Despite the tighter monetary policy stance, the financial conditions have eased spurring the growth dynamics. As a result, the economy emerged from technical recession as of 1Q19 by registering 1.3% sequential growth.
- However, the recovery was not sustainable as the leading indicators and loan growth turned south again implying a sequential drop in 2Q19. As per the contributors, we now think that lower contribution from the private sector consumption side throughout the year is the main reason for the downward revision.
- We also anticipate the investment tendency to remain weak in the coming quarters in tandem with the deleveraging process in the corporate sector.
- The public consumption has been supportive especially in 1Q19, which was significantly evident in worsening budget dynamics. In contrast, we expect some normalization in spending activity in the coming quarters.
- The only material contribution will be coming from net exports side.
- For 2020, we expect a slow recovery in GDP growth towards 2%.

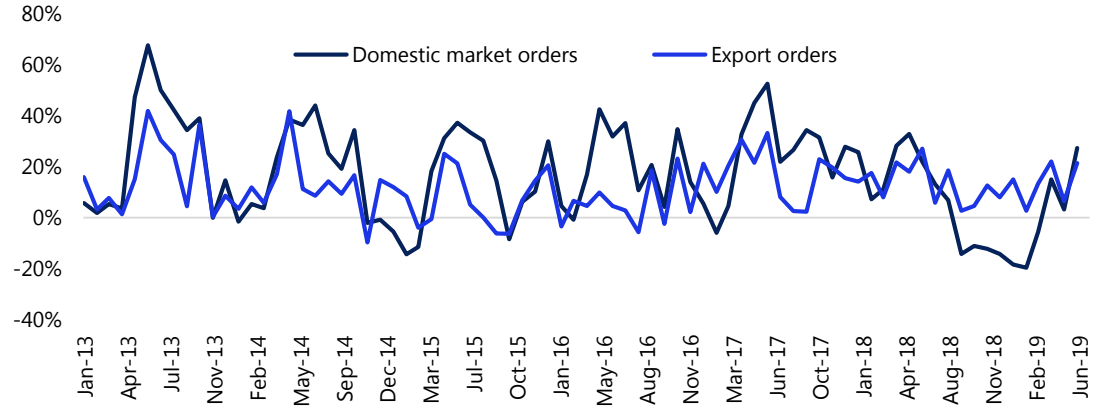
Economic Growth *(Confidence Indices)*

Confidence indices do not portray a sustainable improvement in economic activity

Trend PMI turned south again after some recovery experienced in 1Q19

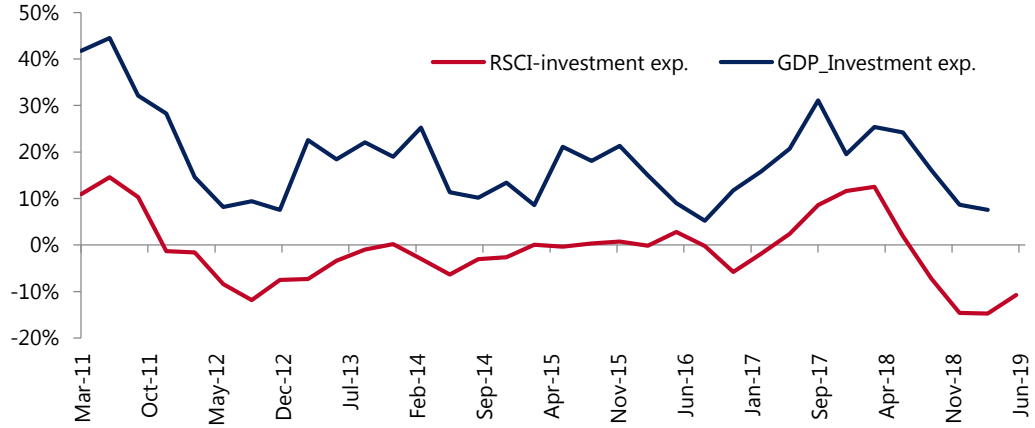


Orders have staged some recovery in June

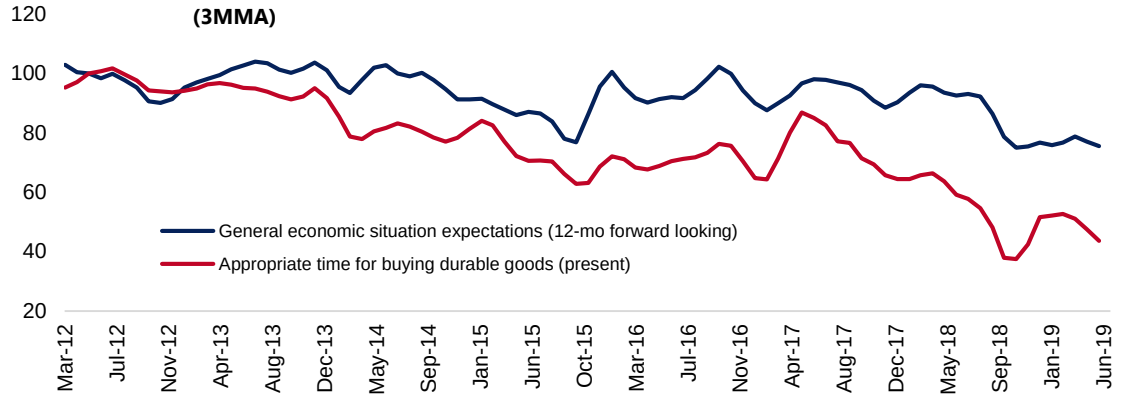


* Orders data shows the difference between percentage of "positive "responses and percentage of "negative "responses for domestic and export orders performance in the last three months.

Investment tendency seems to bottom out as of 1Q19



Consumer Confidence Index stands at record low levels

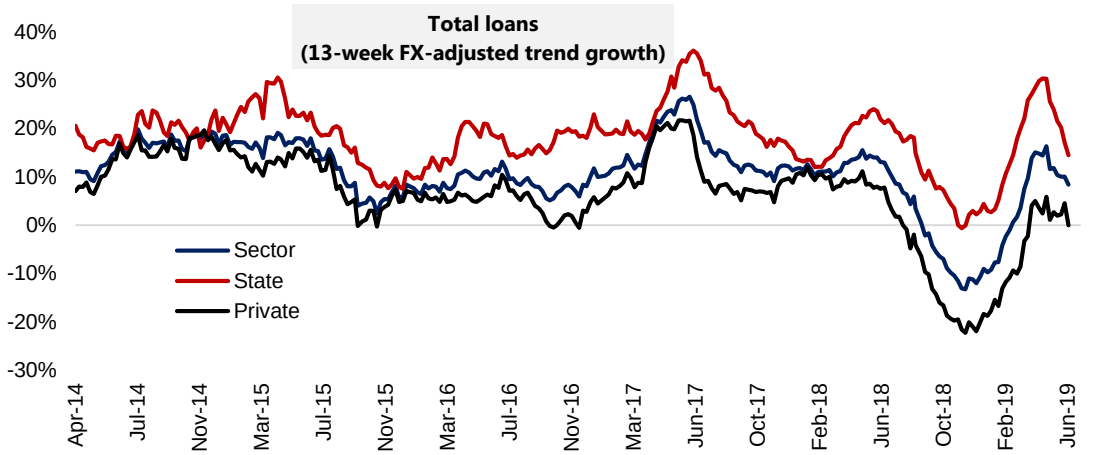


Source: Turkstat, CBT, ISO/Markit, Tacirler Investment

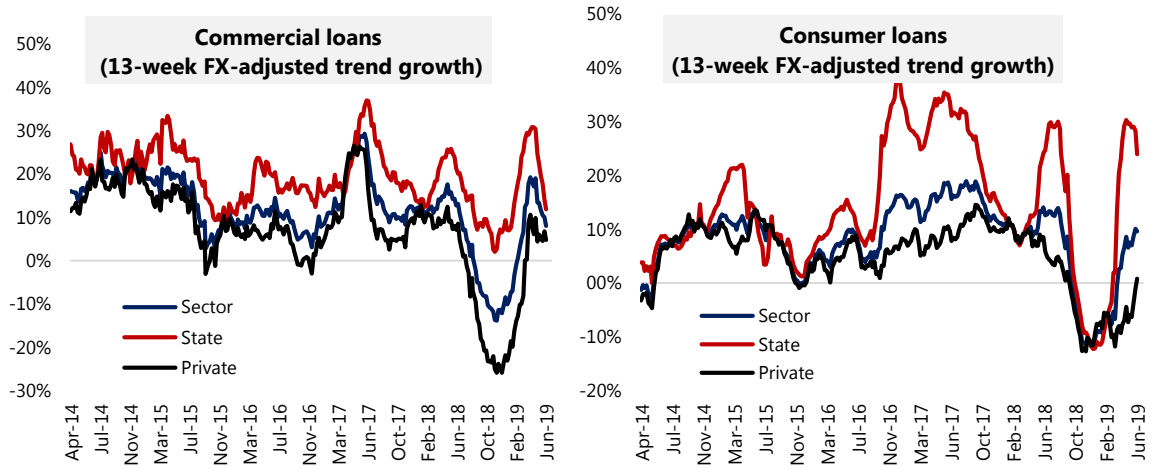
Economic Growth *(Loan tendency)*

Loan growth will be the key determinant of private sector activity

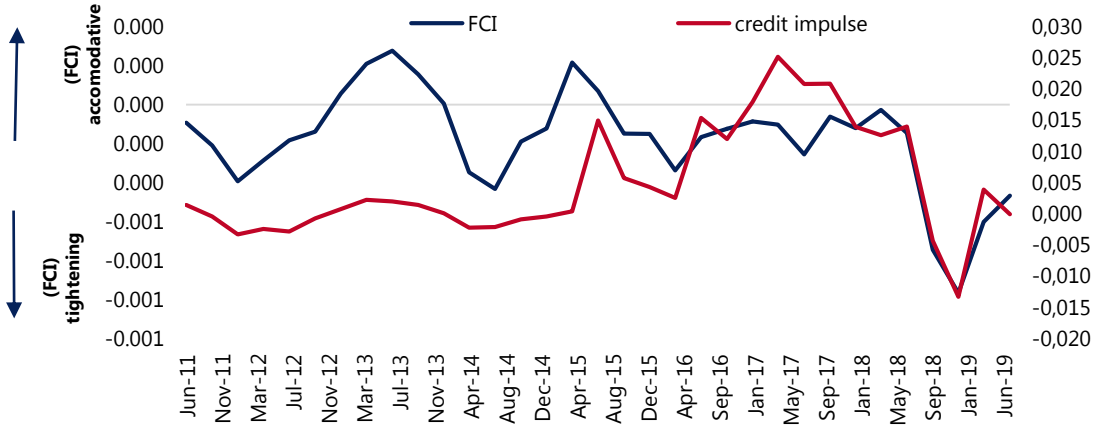
The trend loan growth has been pacing down since the beginning of April



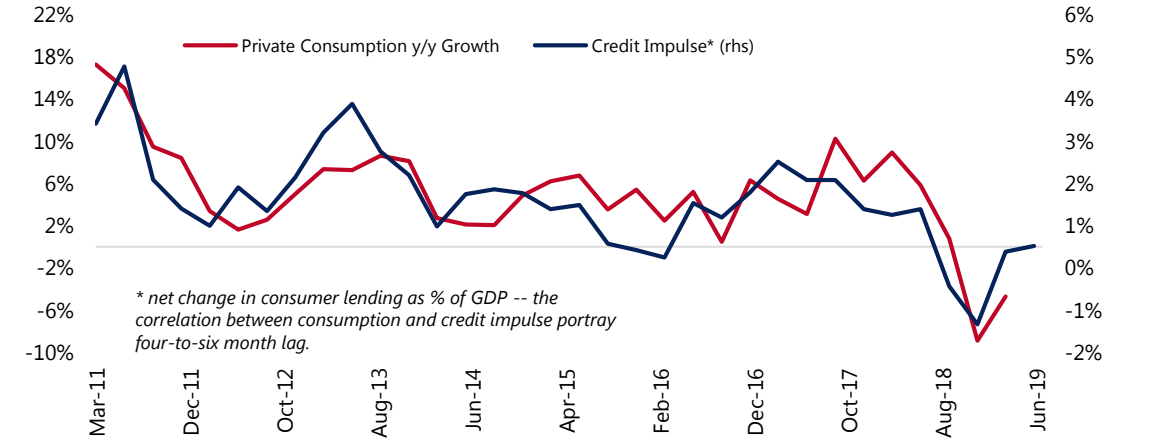
Consumer loan growth at private banks has been quite weak for some time



Tighter financial conditions weigh on growth dynamics



The credit impulse turned negative again as of 2Q19

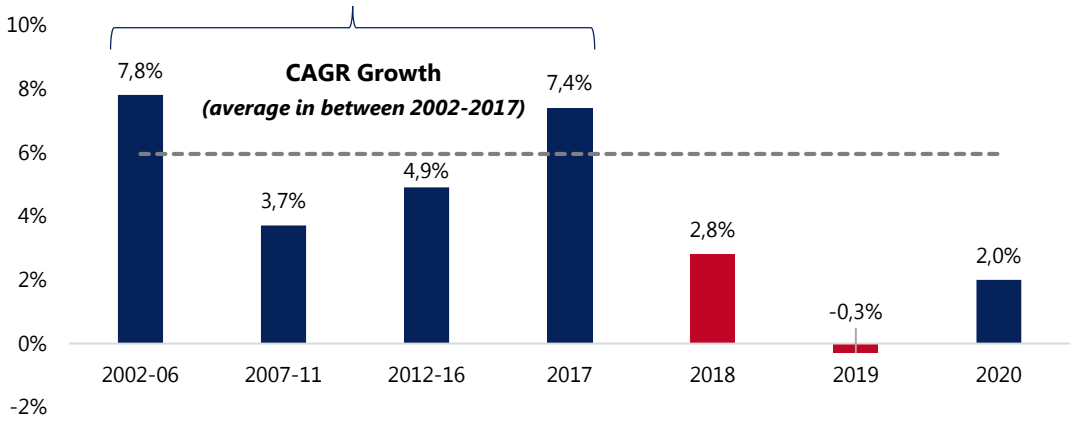


Source: Turkstat, CBT, BRSA, Tacirler Investment

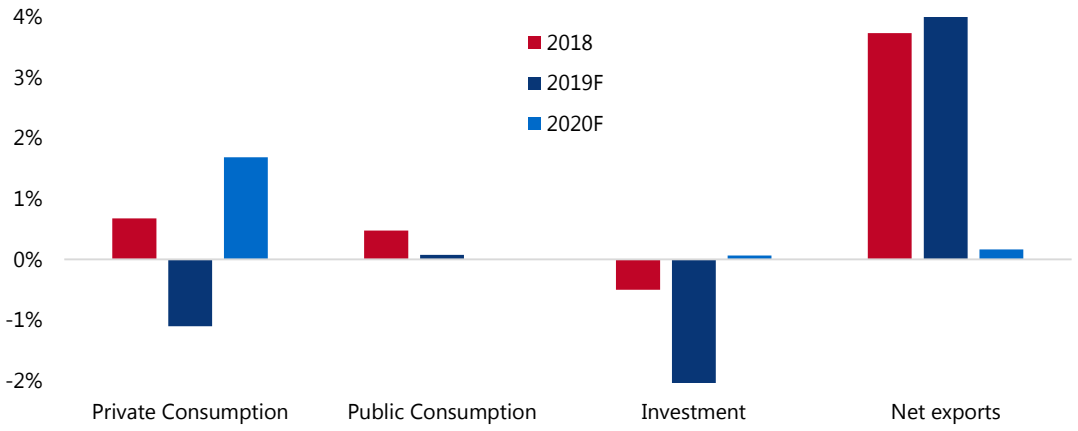
Economic Growth

We revise down our 2019 GDP growth estimate to -0.3% from 1.5%

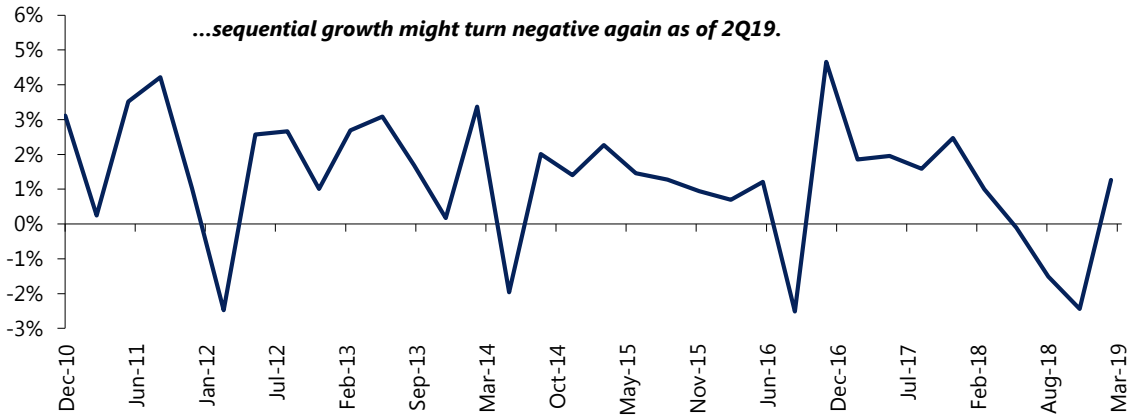
We now estimate a mere GDP contraction in 2019



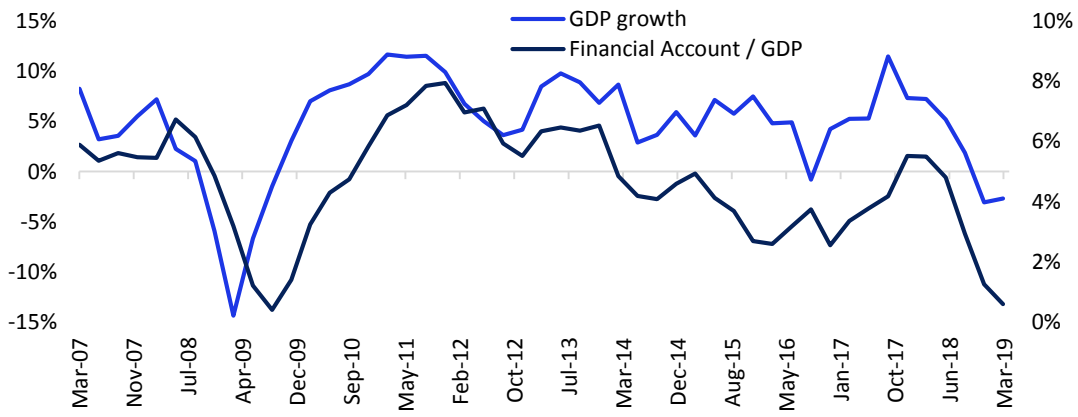
The main catalysts for the growth will be «net exports» performance in 2019



The economy has overcome the technical recession by 1Q19 but…



Economic growth is mostly dependent on capital flows

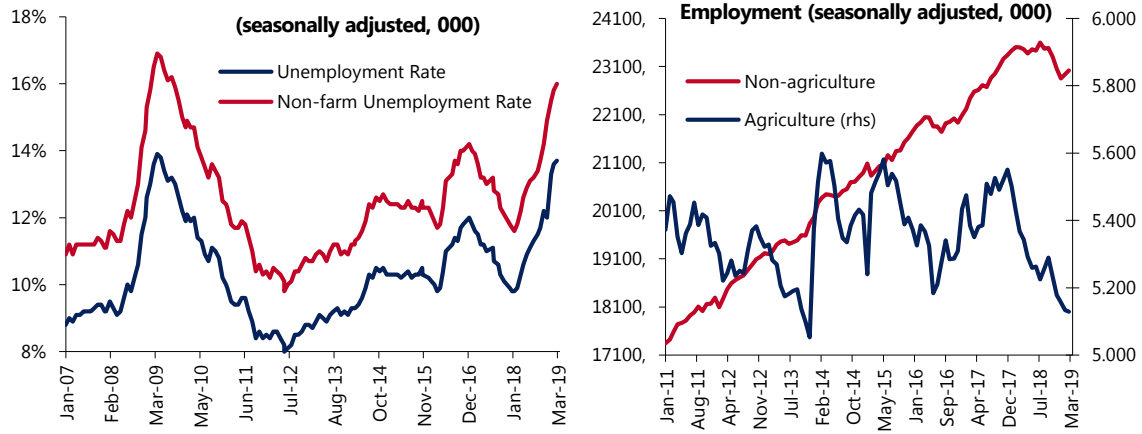


Source: Turkstat, CBT, Tacirler Investment

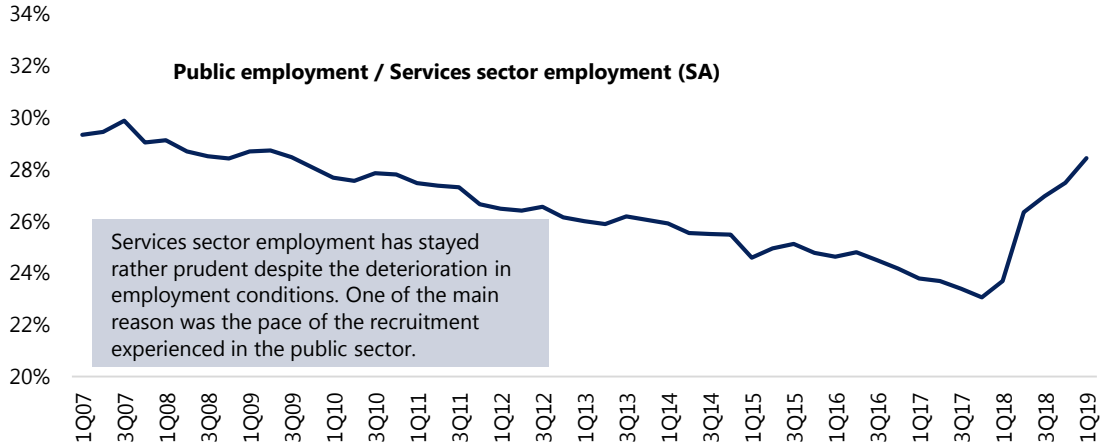
Employment

Weak growth continues to weigh on the job market

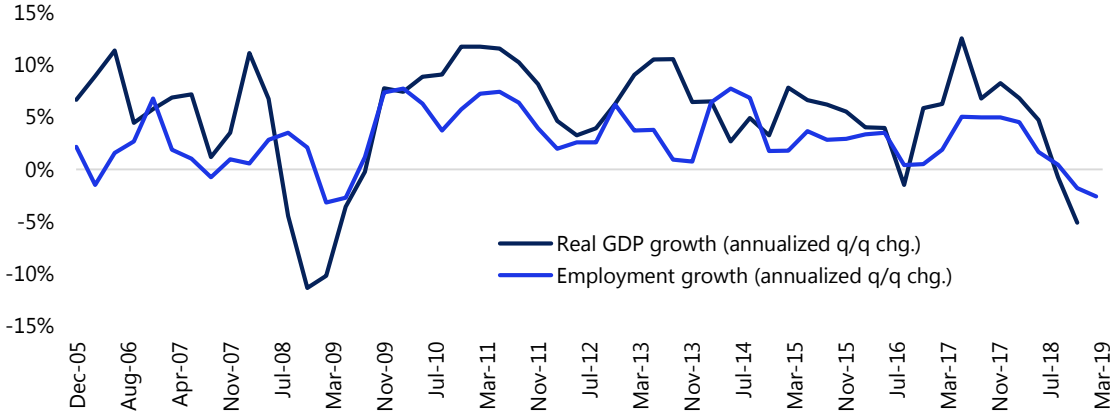
A steep worsening in unemployment rate towards 2009 levels



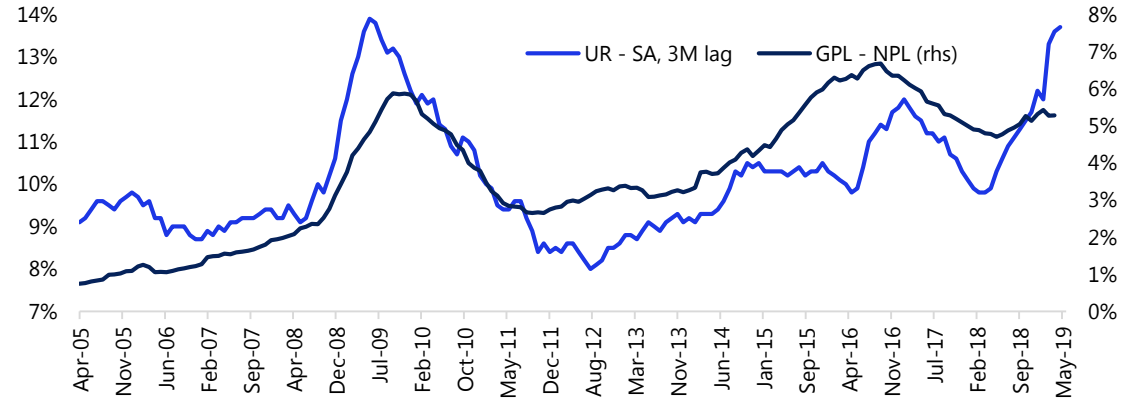
The public employment has boosted since the beginning of 2018



Changes in employment sector take place with a lag



NPL ratio on general purpose loans and UR has a strong correlation



Source: Turkstat, CBT,BRSA,Tacirler Investment

Price Dynamics

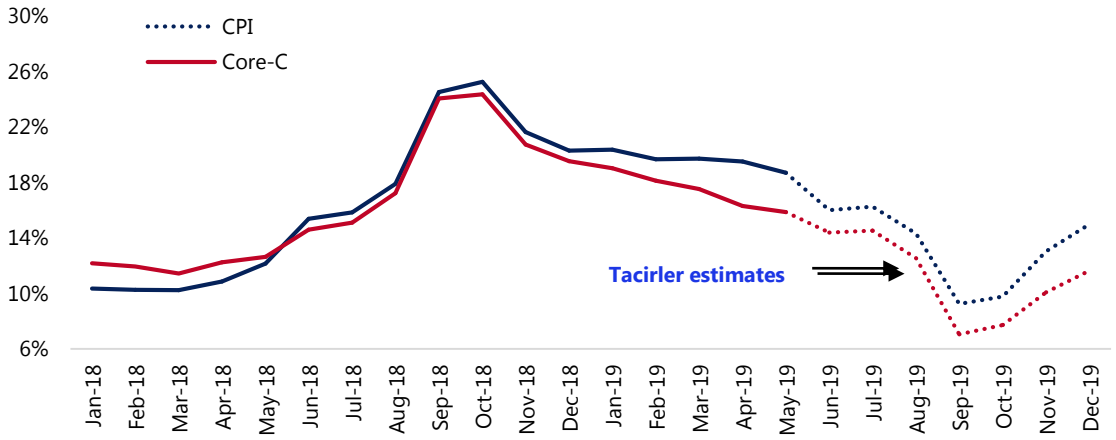
We revise our 2019YE CPI estimate to 15% from 16.3%

- We lowered our 2019 year-end CPI estimate to 15% from 16.3%.
- The main disinflationary factors were (i) extended weakness in domestic demand activity (ii) significant favorable base impact, (iii) the mean reversion attempts in unprocessed food prices and (iv) the sliding scale system on petroleum products prices.
- As per the inflation forecasting path, the strong base effect starting from June will dominate the course of the annual inflation until October 2019. We believe that the annual headline inflation will remain above the CPI-C core indicators, given that the food segment volatility has been taking the lead role in the past months.
- Still, we expect the headline CPI to ease towards 9-10% levels as of September-October in line with the CBT's forecasting path.
- Afterwards, we incorporate a worth noting upward move in the last two months of the year, which will lead CPI to end 2019 at 15%.
- For 2020, we expect the annual CPI to steadily ease towards 11% at the end of the year.

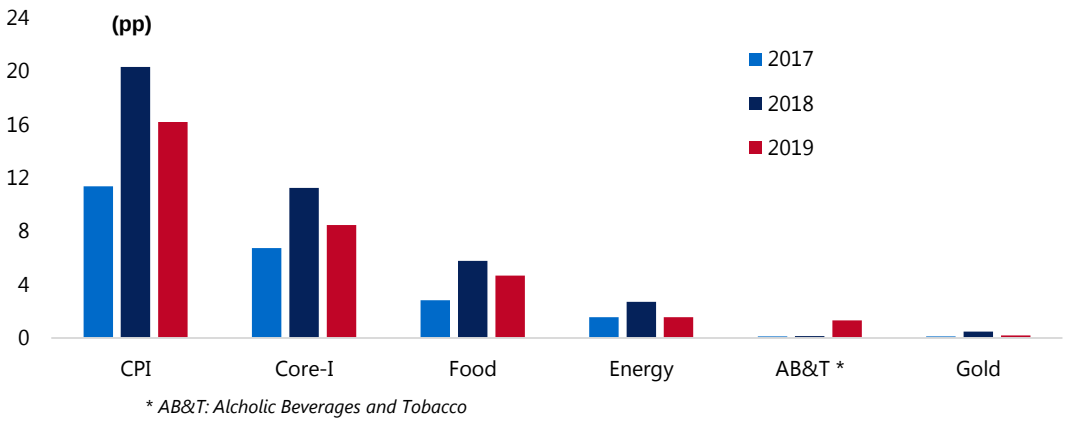
Price Dynamics (I)

Disinflationary factors:(i) weak demand,(ii) base impact,(iii) correction in unprocessed food prices

The decline in annual CPI will accelerate as of June

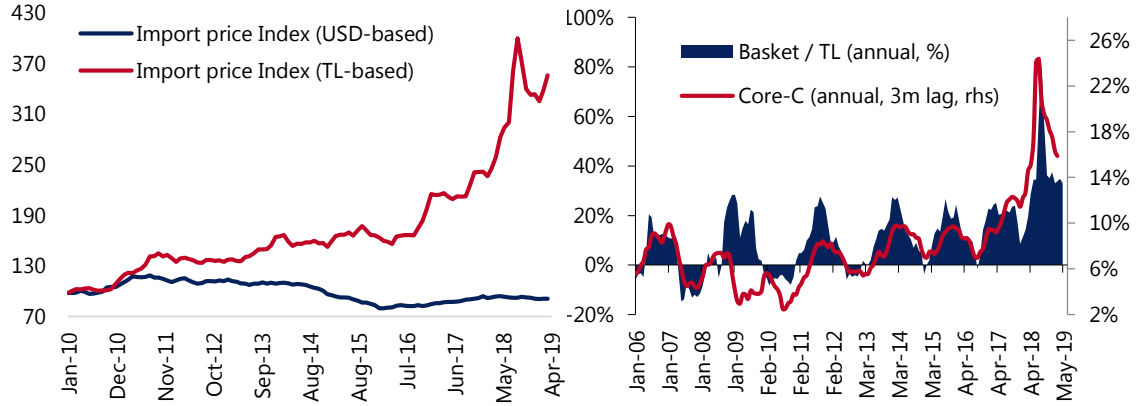


Our 2019 CPI estimate stands at 15%

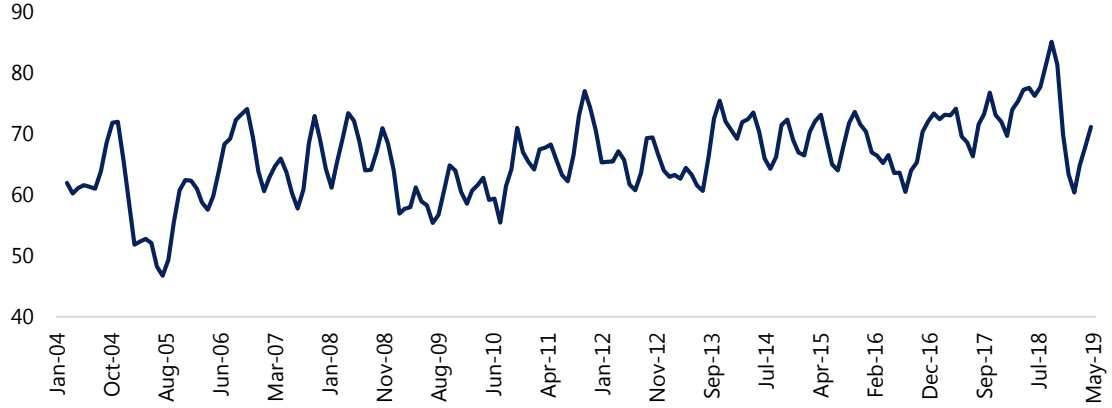


** AB&T: Alcholic Beverages and Tobacco*

Weak domestic activity has been trimming the FX pass through impact



Inflation Diffusion Index reveals a broad based inflationary pressure

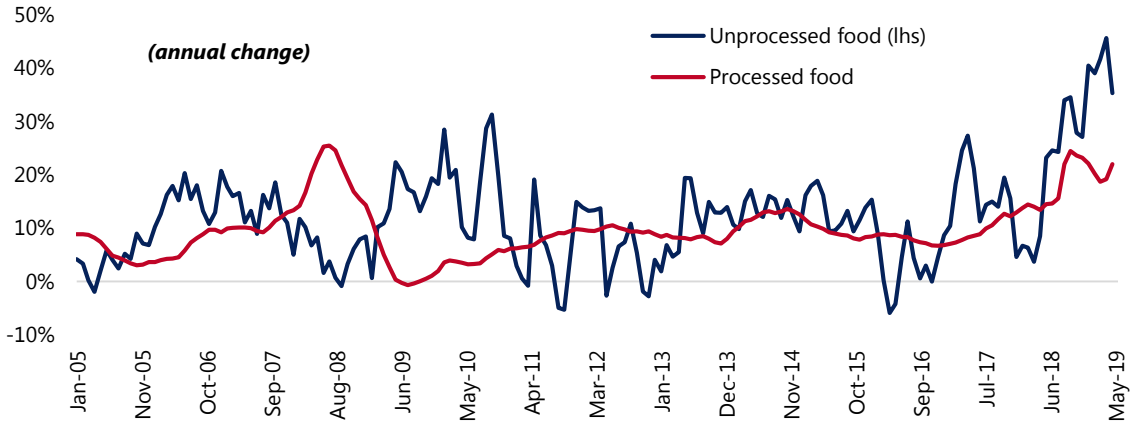


Source: TURKSTAT,CBT, Bloomberg, Tacirler Investment

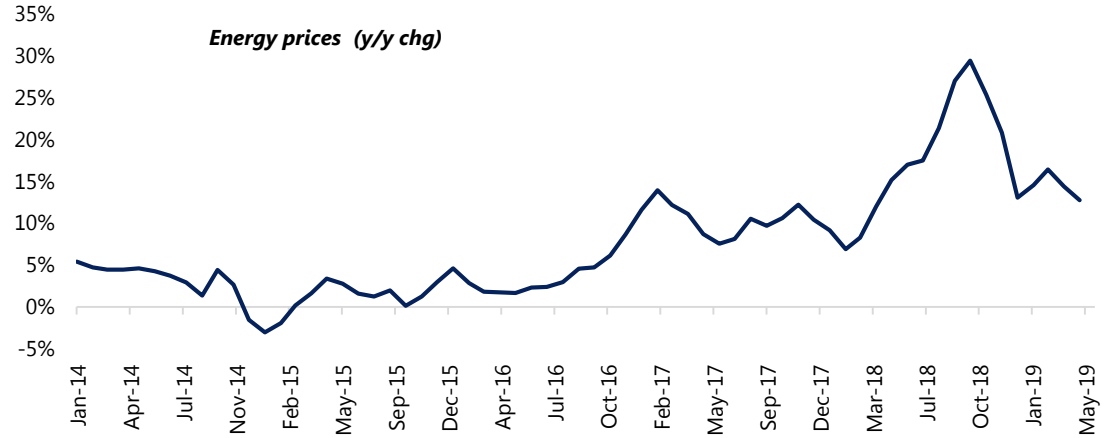
Price Dynamics (II)

Our 2019 CPI estimate stands at 15%

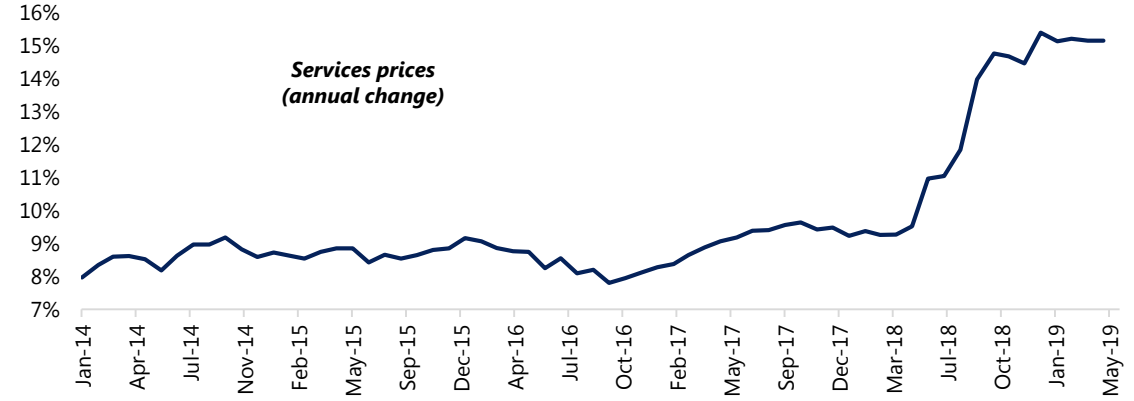
High volatility in unprocessed food prices once again weighing on CPI



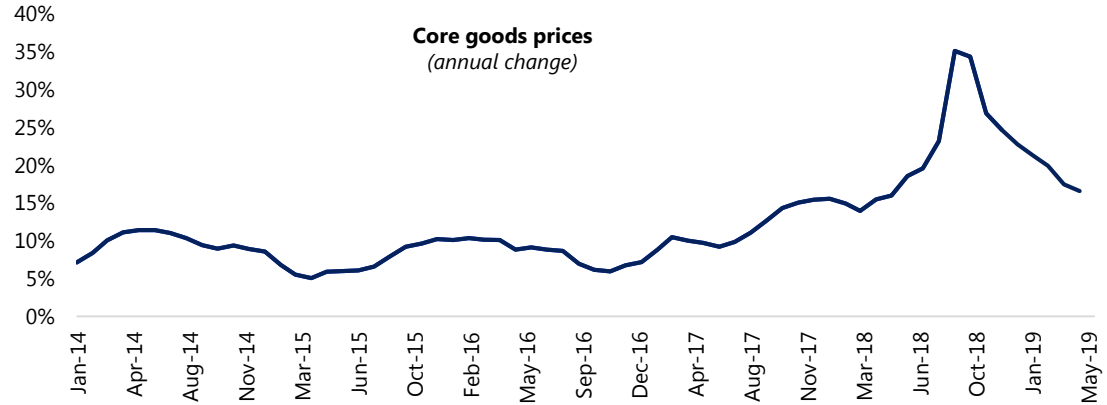
Energy prices remain contained thanks to «sliding scale» pricing mechanism



The services inflation is likely to remain high due to stickiness in prices



Further improvement should be awaited in core goods inflation



Source: TURKSTAT,CBT, Tacirler Investment

Fiscal Dynamics

Normalization expected after spending spree in 1Q19

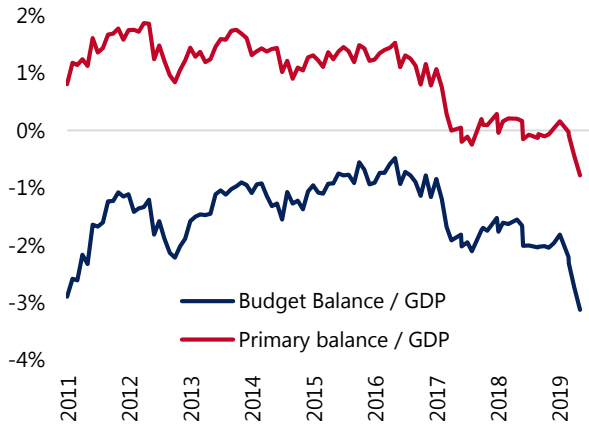
- Following the currency shock experienced in August 2018 that sent the economy to recession, the fiscal side remained significantly supportive especially throughout 1Q19.
- Although we witness some cost-cutting efforts on the spending side so far in 2Q19, the course of the revenue generation remained extremely weak, all of which culminate in a heightened budget deficit to GDP.
- The weak domestic demand activity significantly weighs on the consumption tax performance. In addition, the VAT repayments to the real sector, a “sliding scale” implemented on Special Consumption Tax levied on petroleum products as well as VAT and SCT incentives on several sectors have been eating from the revenue generation.
- The annual budget deficit to GDP as of May has deteriorated to TL118.7bn (3.1% of GDP). Note that the government’s target for this year is 1.8% in the New Economic Program.
- We maintain our 2.3% of budget deficit to GDP estimate for the year-end with an assumption of some normalization on the spending side and slight recovery on the revenue generation. However, risks to this estimate are mainly on the upside.

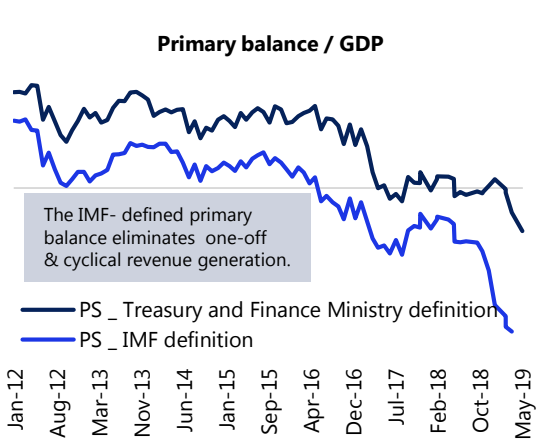
Source: Ministry of Finance, TURKSTAT, Tacirler Investment

Fiscal Dynamics

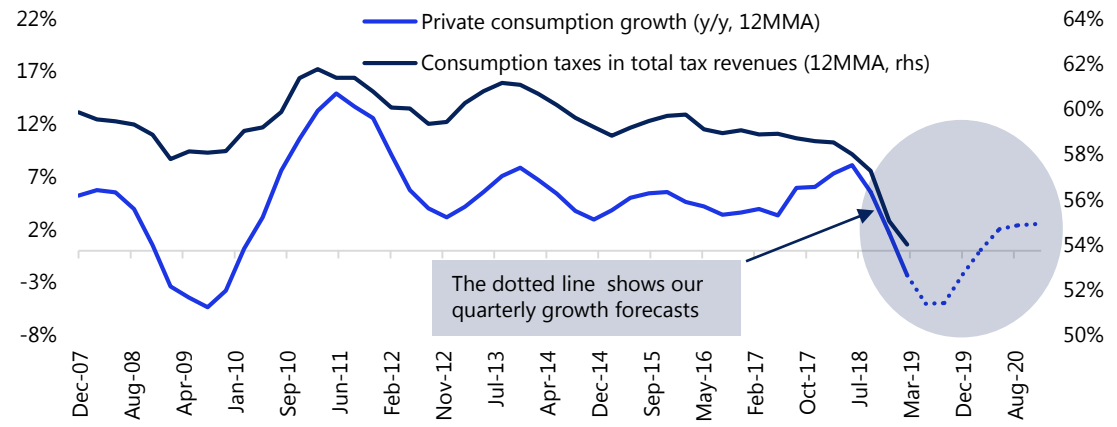
Coherent fiscal policy is crucial in a combination of weak activity & high inflation

The deterioration has deepened in the fiscal dynamics especially in 1Q19





Weak domestic activity has been weighing on the revenue generation



Spending activity shows signals of some slowdown as of April

(TL bn)	Annual Realizations	5M18 Realiz.	5M18 as % of overall	Budget Targets	5M19 Realiz.	5M19 as % of overall	Jan-May y/y nom. chg.
Budget Expenditures	**830.5**	**322.5**	**38.8%**	**961.0**	**414.0**	**43.1%**	**28.4%**
Non-interest expenditures	756.5	*291.1*	*38.5%*	*843.7*	*367.6*	*43.6%*	*26.3%*
Personnel exp	200.9	81.9	*40.8%*	247.3	106.0	*42.9%*	*29.4%*
Social Security Premium exp.	34.4	13.6	*39.7%*	43.4	18.4	*42.5%*	*35.2%*
Goods and Services Purch. exp.	71.7	25.6	*35.7%*	67.6	26.5	*39.3%*	*3.6%*
Current Transfers	323.1	124.7	*38.6%*	391.3	169.7	*43.4%*	*36.1%*
Capital Expenditures	88.0	30.1	*34.2%*	54.4	27.7	*50.9%*	*-8.1%*
Capital Transfers	16.7	7.0	*42.0%*	10.0	7.0	*69.4%*	*-0.9%*
Liabilities	21.7	8.0	*37.1%*	21.7	12.3	*56.4%*	*52.6%*
Reserve appropriations	0.0	0.0	-	7.9	0.0	*0.0%*	*n.m*
Interest expenditures	*74.0*	31.4	*42.5%*	117.3	46.4	*39.5%*	*47.6%*

… but revenue generation has been quite weak since the beginning of 2019

(TL bn)	Annual Realizations	5M18 Realiz.	5M18 as % of overall	Budget Targets	5M19 Realiz.	5M19 as % of overall	Jan-May y/y nom. chg.
Budget Revenues	**757.8**	**302.1**	**39.9%**	**880.4**	**347.5**	**39.5%**	**15.0%**
Tax revenues	621.3	*252.1*	*40.6%*	*756.5*	*262.9*	*34.7%*	*4.3%*
Income Tax	139.0	53.8	*38.7%*	171.9	62.8	*36.5%*	*16.7%*
Corporate Tax	78.7	34.3	*43.6%*	74.2	36.4	*49.0%*	*5.9%*
Domestic VAT	56.4	25.0	*44.3%*	70.7	19.9	*28.1%*	*-20.5%*
Special Consumption Tax	133.9	56.5	*42.2%*	162.6	52.7	*32.4%*	*-6.8%*
Banking and Ins. Transac. tax	18.2	6.6	*36.5%*	19.0	8.8	*46.4%*	*32.8%*
VAT on imports	122.1	44.4	*36.4%*	165.8	49.2	*29.7%*	*10.7%*
Stamp Tax	17.0	7.2	*42.5%*	20.8	8.1	*38.9%*	*12.6%*
Fees	21.7	9.6	*44.2%*	27.7	9.4	*34.0%*	*-1.4%*
Others	*34.5*	14.6	*42.3%*	43.8	15.7	*35.7%*	*7.4%*
Non-tax revenues	*136.5*	*50.0*	*36.6%*	*123.9*	*84.6*	*68.3%*	*69.3%*

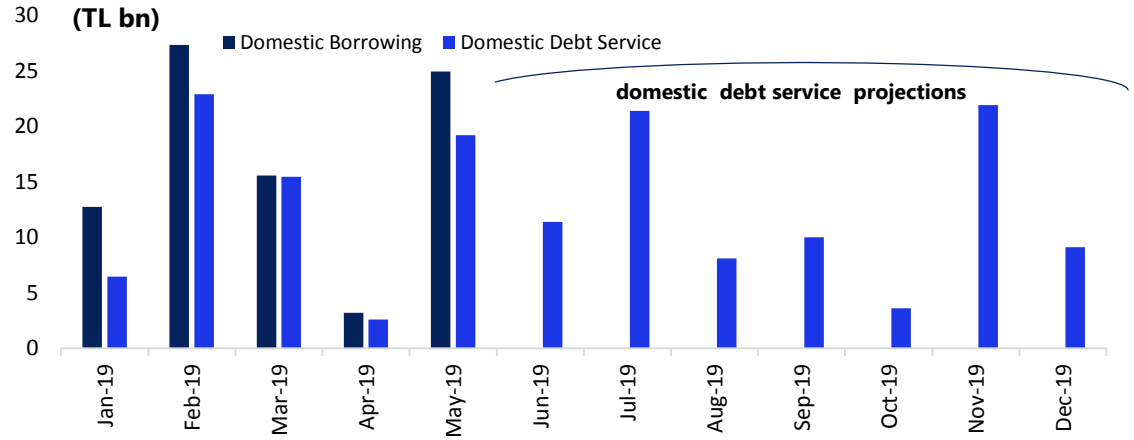
* *Non-tax revenues also include Revenues from Special* 37.73

Source: Treasury and Finance Ministry, TURKSTAT, Tacirler Investment

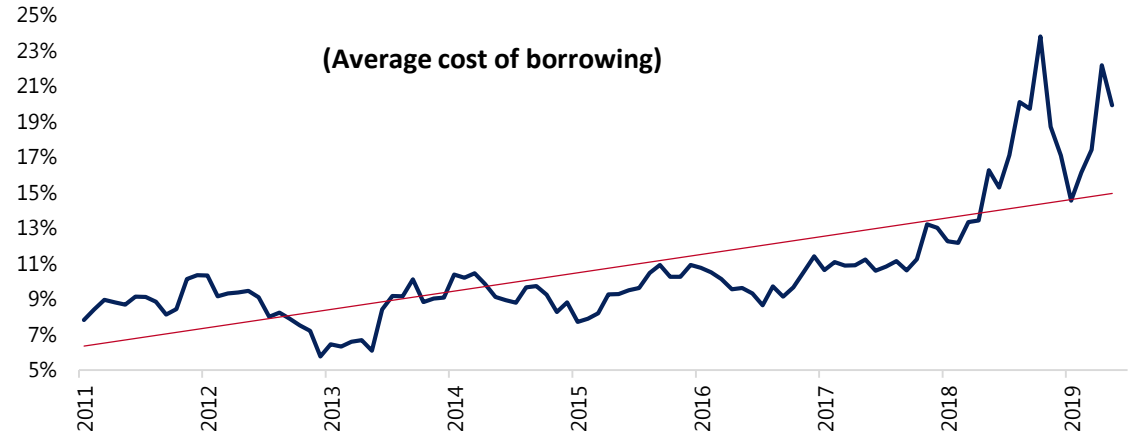
Domestic debt borrowing and service

Domestic rollover ratio has been over 100% since the beginning of 2019

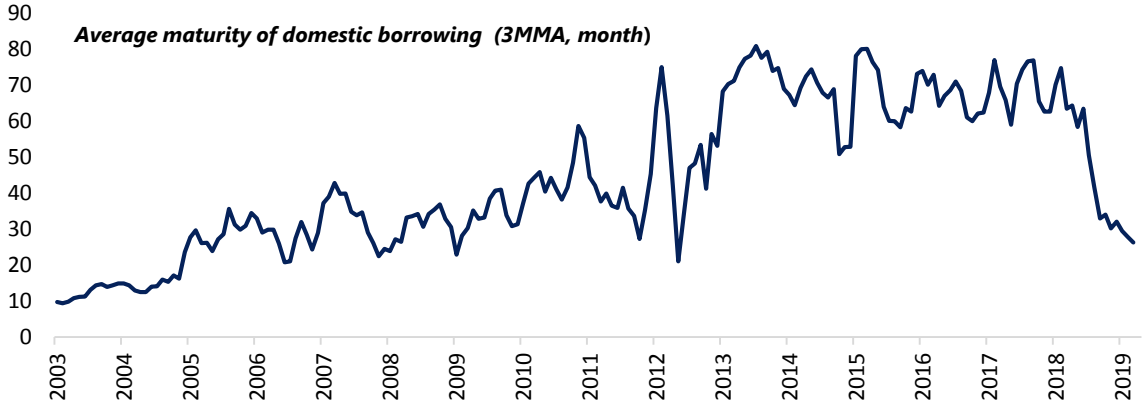
The rollover ratio has been over 100% since the beginning of 2019



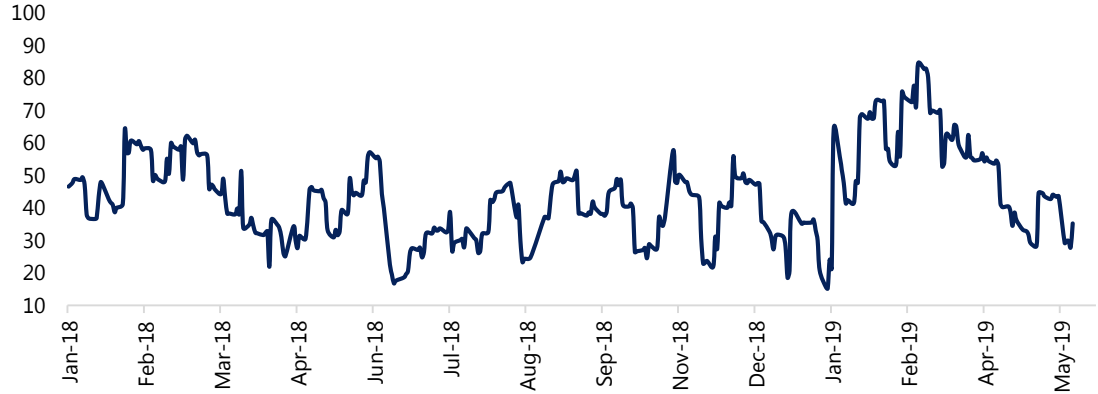
The rising average cost of borrowing adds further to the interest spending



A sharp decline in the average maturity of the domestic borrowing



Treasury's deposit (both FX+TRY) at the CBT's accounts

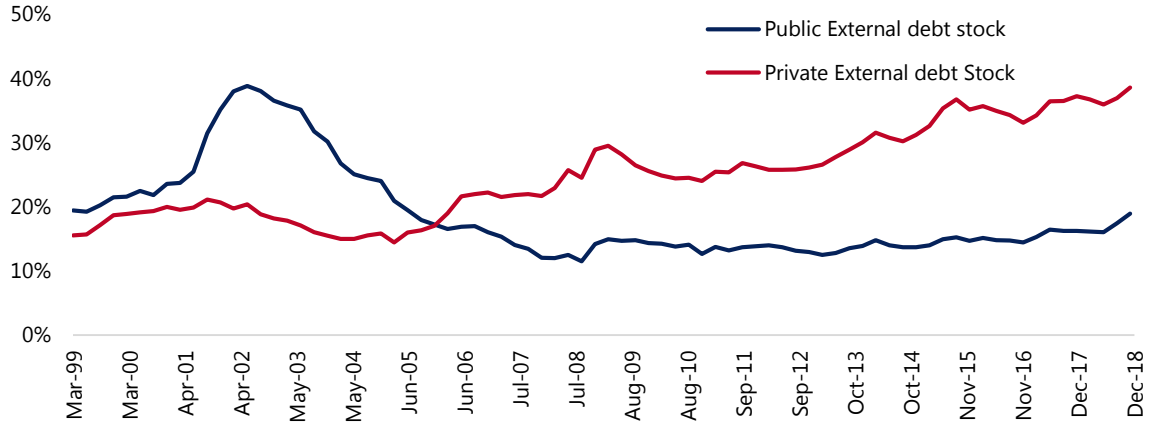


Source: TURKSTAT,CBT, Bloomberg, Tacirler Investment

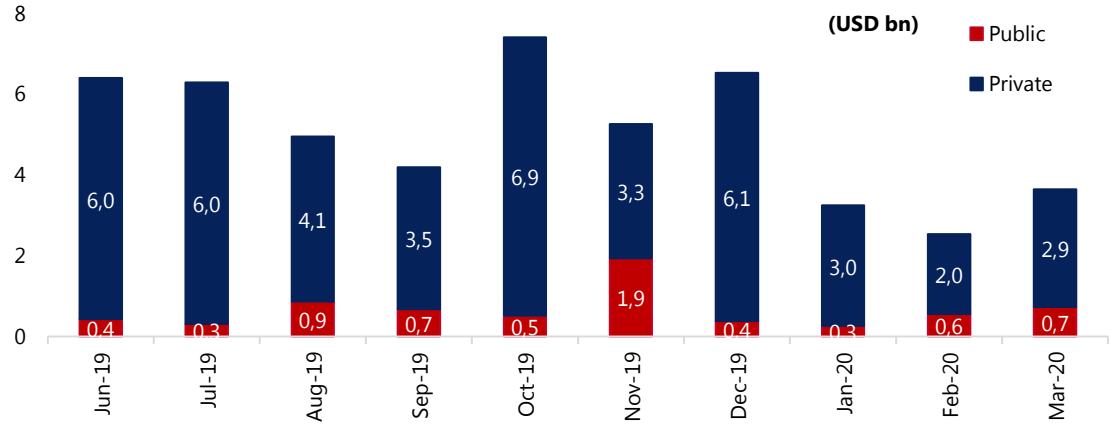
External debt borrowing and service

Treasury has almost reached its 2019 external borrowing target in 1Q

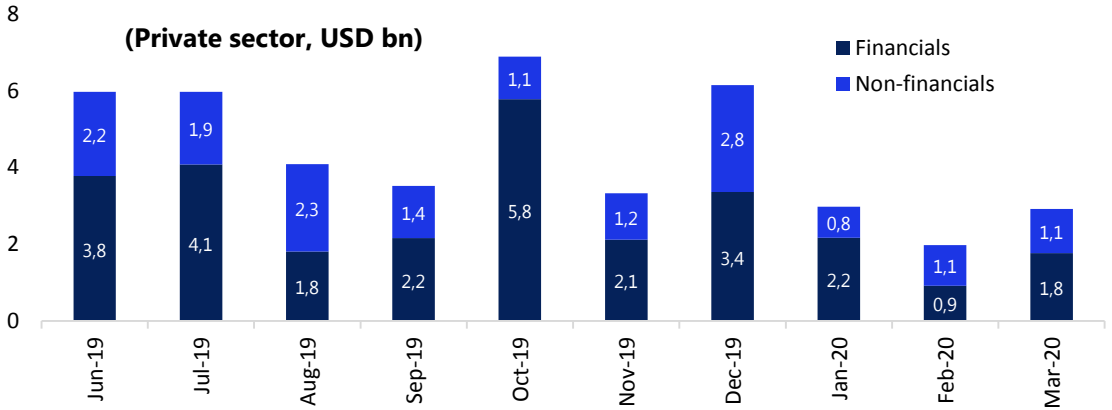
Turkey's external debt stock to GDP is at 56.7% as of 2018YE



Public sector external debt payment for the next 12-month is quite low



Highest monthly external debt payment for the next 12-month is due October



The Treasury tapped the international markets by USD6.4bn so far this year

International Bond Issuances in 2019

Issue Date	Currency	Size	Maturity Date	Coupon Rate (%)	Price (%)	Yield to Investor (%)	Yield to Investor (Spread)	EUR Coupon Rate (%)
16.01.19	USD	2 bn	26.04.29	7.625	99.56	7.68	UST + 497 bps	4.965
31.01.19	EUR	1.25 bn	31.03.25	4.625	99.36	4.75	MS + 446 bps	–
26.03.19	USD	1 bn	26.04.29	7.625	103.3	7.15	UST + 454 bps	4.859

International Lease Certificate Issuance in 2019

Issue Date	Currency	Size	Maturity Date	Lease Rate (%)	Price (%)	Yield to Investor (%)	Yield to Investor (Spread)
21.02.19	USD	2 bn	21.02.22	5.8	100	5.8	MS + 318 bps

Source: CBT, Treasury and Finance Ministry, Tacirler Investment

External Demand

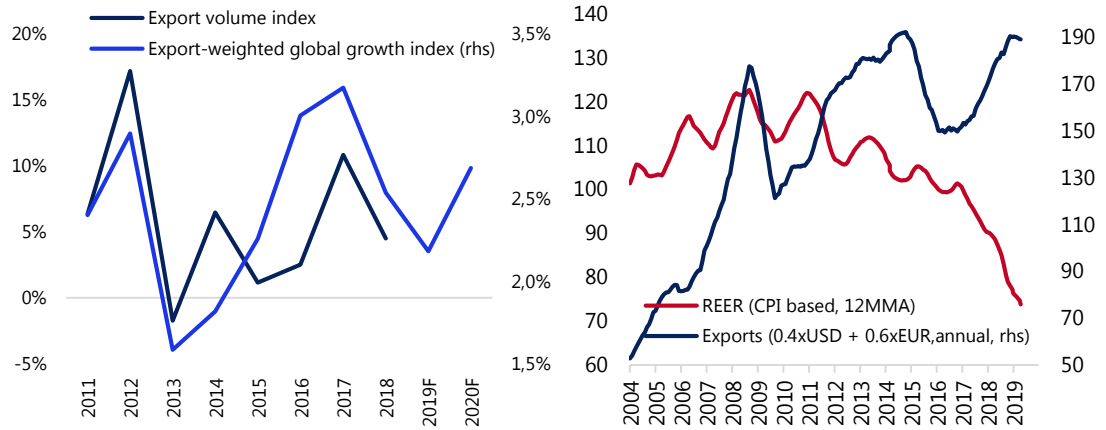
Our 2019 CAD estimate now is USD4.5bn down from USD16.7bn

- The CAD adjustment has been much sharper than expected and in fact the most rapid one in historical terms. 12-month CAD has eased below USD10bn from USD58bn only in a year period.
- We expect a mere surplus in current account balance in 3Q19 and forecast a deficit of USD4.5bn (0.6% of GDP) at the end of the year. We also believe the risks are on the downwards (meaning a narrower CAD).
- The weak domestic demand activity was one of the main pillars, but few other factors especially solid external demand has also added to the better CAD performance since May 2018: (i) Goods exports posted a growth rate to the tune of 4% y/y, (ii) gross tourism revenues rose by 8% y/y, (iii) the gold trade has normalized markedly – annual gold imports, which reached USD19bn in April 2018, has come down to USD8.8bn.
- As per 2020, we might see higher imports performance with some improvement in economic activity. In addition, although the export-weighted global growth index will show a stronger performance in 2020 according to the IMF estimates, the risks for a slowdown in global economy are significantly high, which caused major global central banks to signal dovish messages lately. Hence, we think that the export performance might be under pressure next year. Moreover, we believe that the tourism sector will continue to contribute positively to the current account balance in 2020. Consequently, we project 2020 CAD at USD12bn (1.6% of GDP).

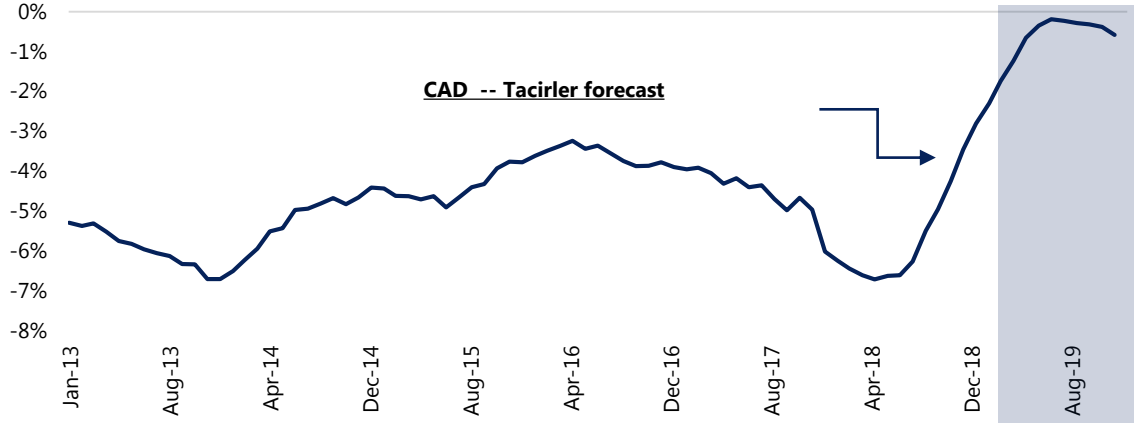
External Demand

The current account deficit will continue to improve throughout 2019

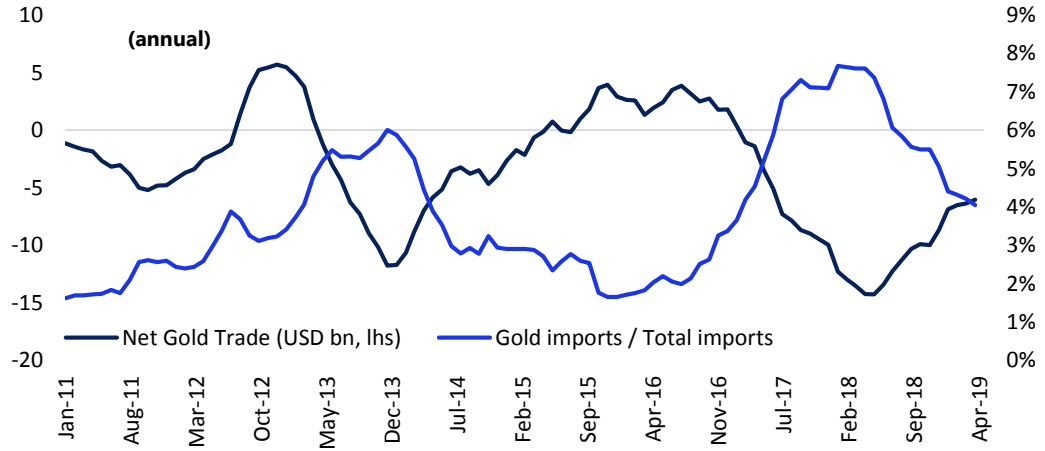
We expect exports to rise 4% y/y this year with some downside risks



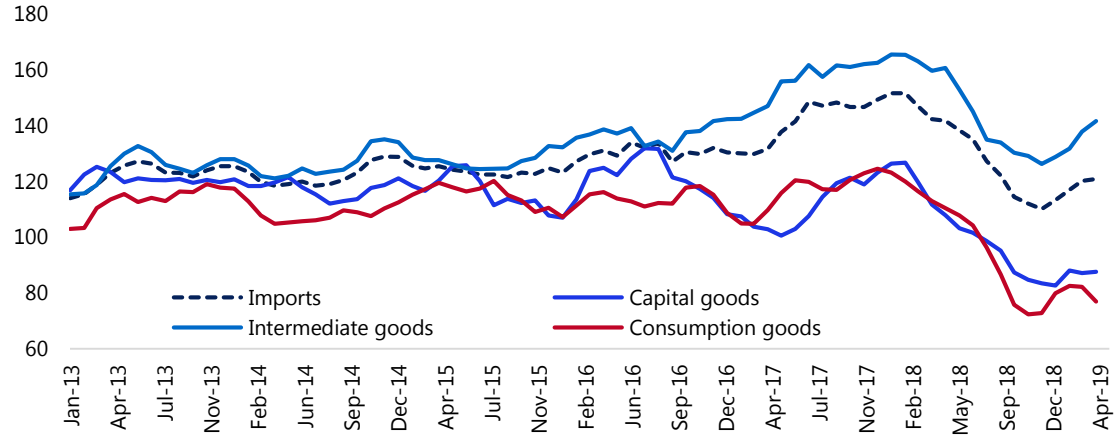
We revise our 2019YE CAD estimate to USD4.5bn from USD16.7bn



Almost 20% of CAD ease since May stemmed from gold trade normalization



The consumption goods imports volume index depicted the sharpest decline

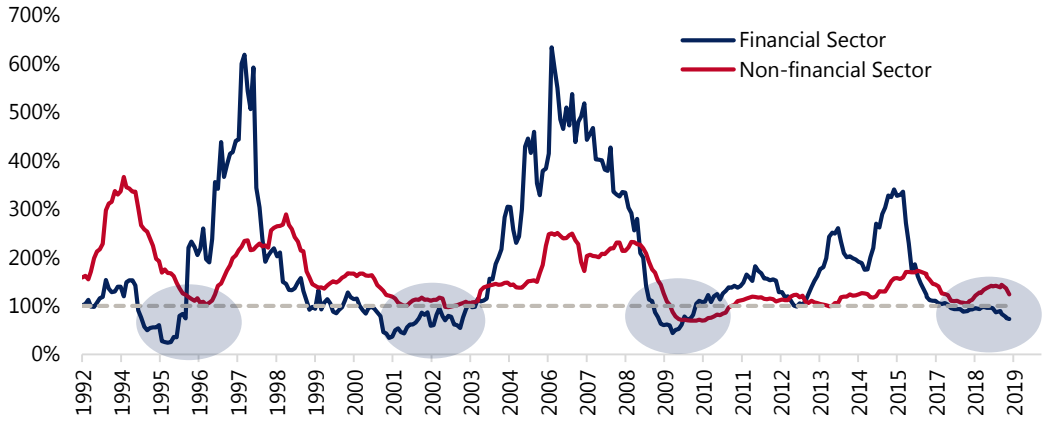


Source: CBT, World Bank, TURKSTAT, IMF, Tacirler Investment

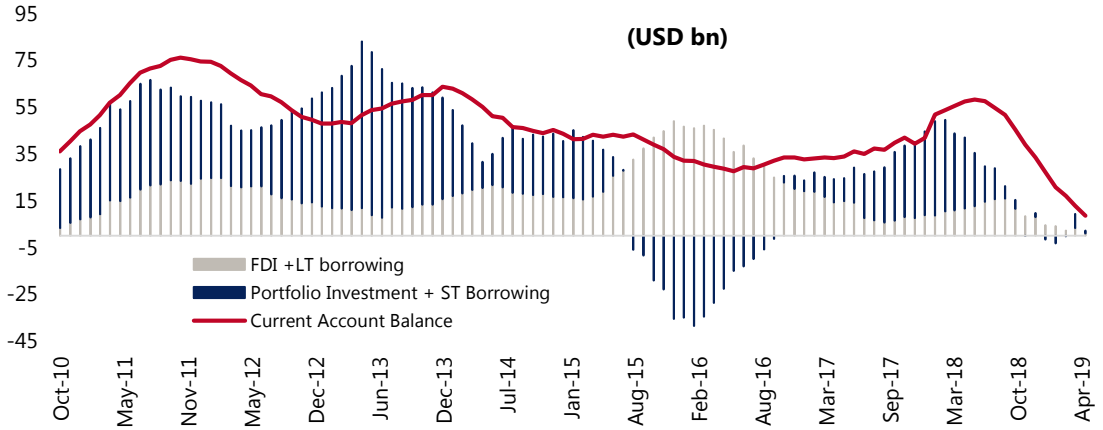
External Financing

Annual «external financing need» remains high at 20% of GDP

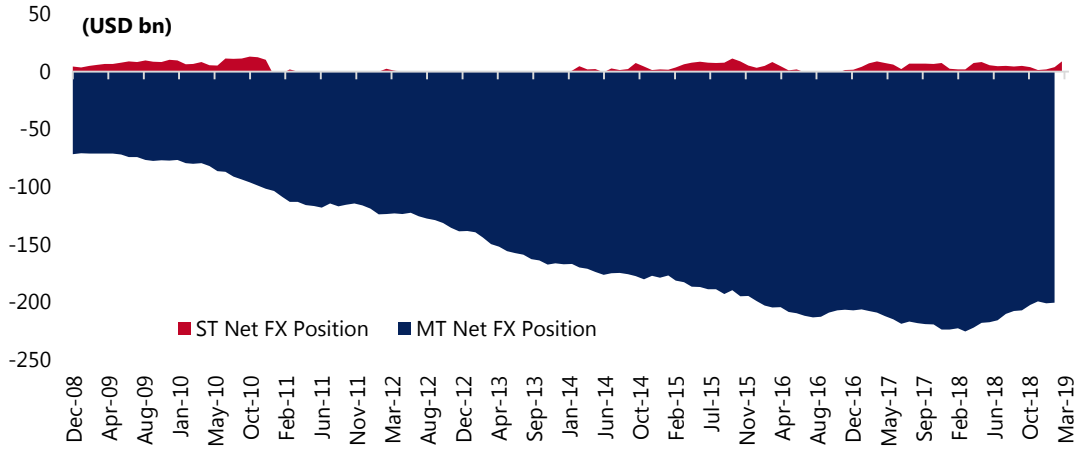
Corporate sector LT external debt rollover ratio is close to 100%



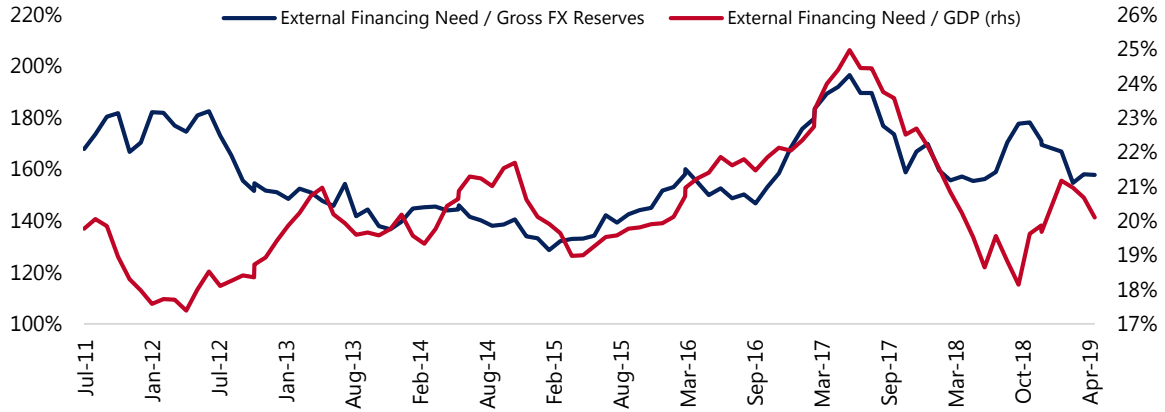
The amount of capital flows has been weakening since 2018



FX Assets & Liabilities of Non-Financial Companies



Annual «external financing need» remains high at 20% of GDP

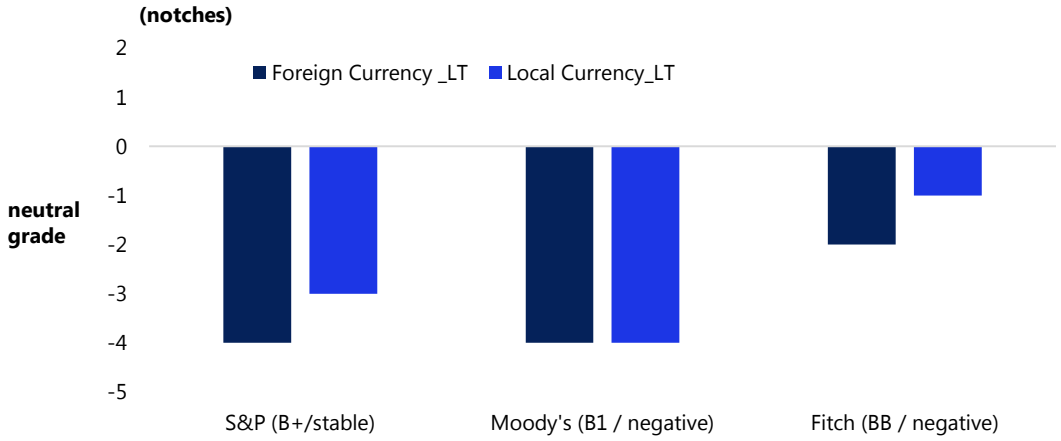


Source: CBT, World Bank, Moody's, IMF, Tacirler Investment

Sovereign Rating

Turkey has experienced sharp rating downgrades in the past two years

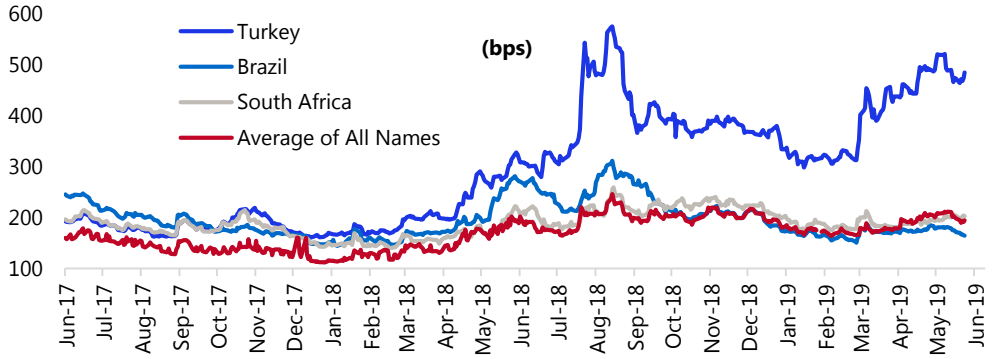
Turkey's sovereign ratings scale



EM Sovereign Rating Scale

	Moody's		S&P		Fitch
Speculative Grade	Ba1	Morocco, Guatemala, Namibia	BB+	Bahamas, Azerbaijan	BB+ South Africa
	Ba2	Croatia, Brazil, Georgia, Azerbaijan	BB	South Africa, Vietnam	BB Turkey, Guatemala, Vietnam
	Ba3	Bangladesh, Bolivia, Vietnam, Senegal	BB-	Bangladesh, Guatemala, Brazil, Bolivia	BB- Brazil, Bolivia, Greece
	B1	Suriname, Turkey, Greece, Jordan	B+	Kenya, Greece, Turkey	B+ Kenya, Nigeria, Egypt
	B2	Cambodia, Argentina, Nigeria, Kenya	B	Sri Lanka, Nigeria, Belarus, Egypt, Argentina	B Argentina, Belarus
	B3	Egypt, Sri Lanka, Argentina, Kenya	B-	Pakistan, Ukraine, Iraq	B- Ukraine, Ecuador
	Caa1	Ukraine, Iraq	CCC+	Republic of Congo	CCC Republic of Congo
	Caa2	Republic of Congo, Republic of Zambia	CCC		CC
	Caa3	Barbados, Mozambique	CCC-		C
	Ca		CC		D
	C		C		
			D		

Turkey's 5y CDS remained high at above 450 bps levels



**Argentina, Turkey, Brazil, South Africa, Mexico, Russia, Indonesia, Malaysia, Philippines, Thailand, Bulgaria, Crotia, Czech, Egypt, Estonia, Greece, Hungary , India, Poland, Romania, Ukraine.*

One rating action since the beginning of the year: Moody's downgrade

2019 Review Calendar of Rating Agencies for Turkey's Sovereign Rating		
Fitch	*3-May (rating/outlook confirmed)*	1-Nov
S&P	*15-Feb (rating/outlook confirmed)*	2-Aug

For Moody's the Sovereign Release Calendar includes sovereign issuers that are covered by a Lead Analyst based in the EU , as required by EU regulation and, in order to provide greater market clarity, it also includes EU sovereign issuers that are covered by Lead Analysts based outside of the EU. As Turkey is not part of the EU and the Lead Analyst is not based in the EU, it is not on the calendar.

Source: Rating Agencies, Bloomberg, Tacirler Investment

Monetary Policy

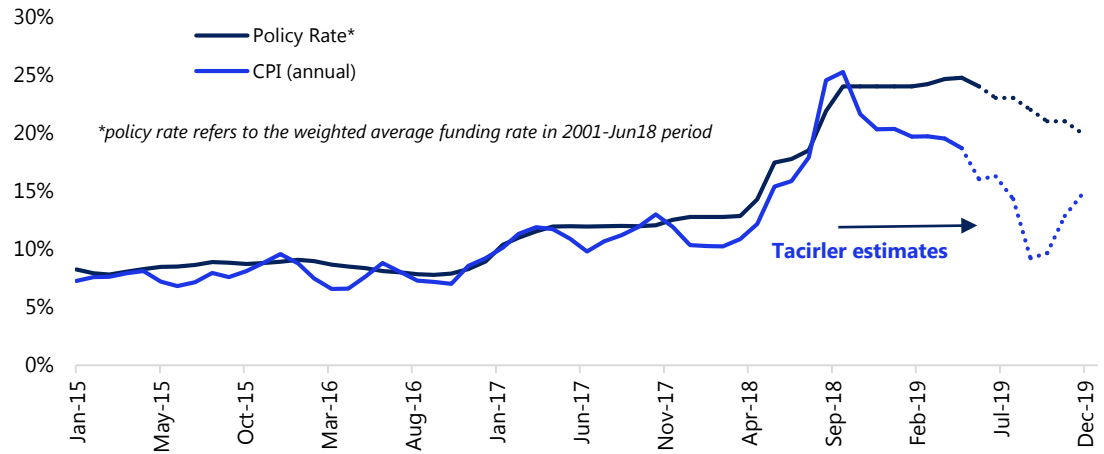
We expect monetary policy easing cycle to kick off as of July

- We believe that the decision note of the MPC in June is a confirmation of the expected improvement in inflation. We also think that the annual inflation will ease more notably as of June throughout October this year.
- Under these circumstances, we maintain our view that the MPC will kick off a rate cut cycle at the next meeting slated for July 25. In tandem with our downward revision in 2019YE CPI estimate, we now look for a 400bps policy rate cut (instead 300bps) towards 20% until the end of this year.
- In addition, we incorporate a total of 300bps cut towards 17% for 2020.
- We believe the improvement in risk premium indicators in the coming period will be key in respect our base case scenario. The CBT at its latest quarterly Inflation report made it clear that "…in the upcoming period, Turkey's risk premium trend will be decisive in inflation and growth dynamics". In fact, the Bank also sees "a delay in the expected partial recovery of the risk premium" as a key risk.
- A noteworthy relief on risk premium and restoring the credibility is at utmost importance in order to put a cap on further FX demand coming from the residents. The households have been adding to their long FX position markedly since August, which totaled to a cumulative USD23bn.

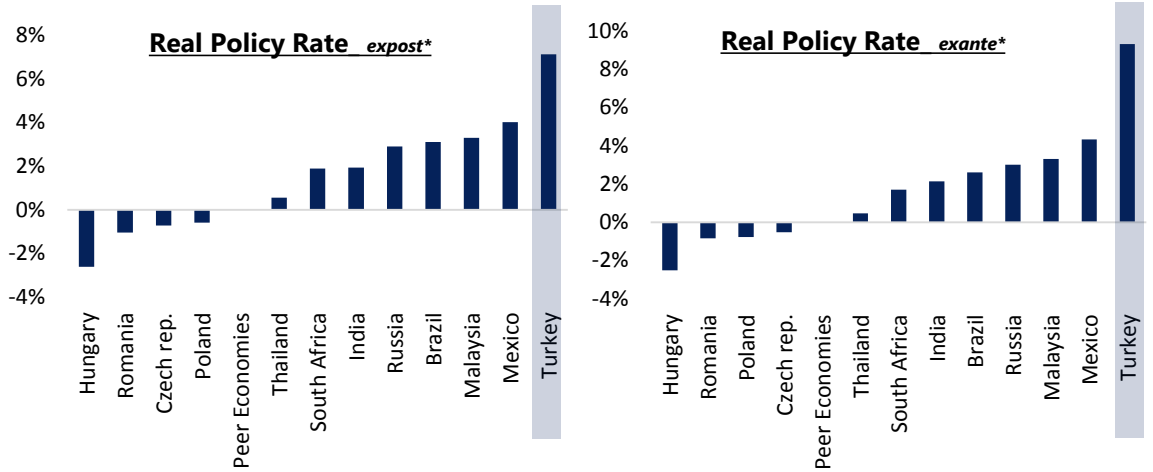
Monetary Policy & Yields

We expect monetary policy easing cycle to kick off as of July

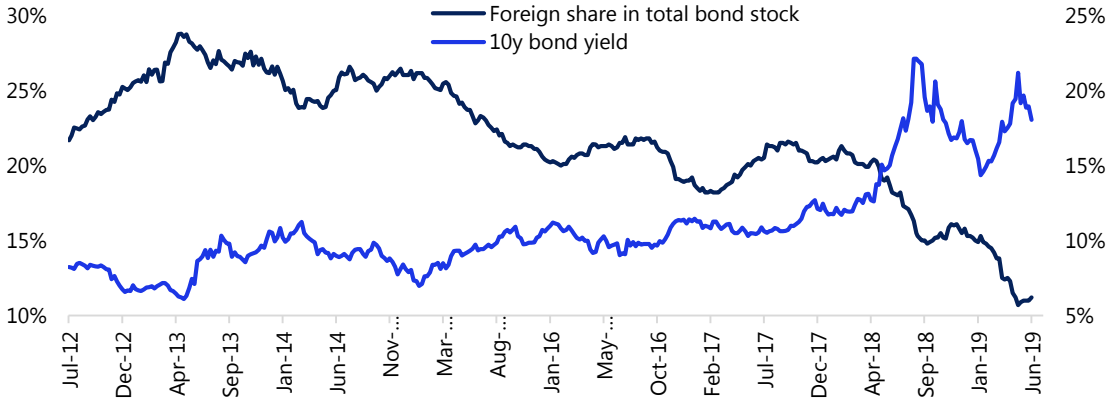
We expect one-week repo rate (policy rate) to ease 20% from 24% this year



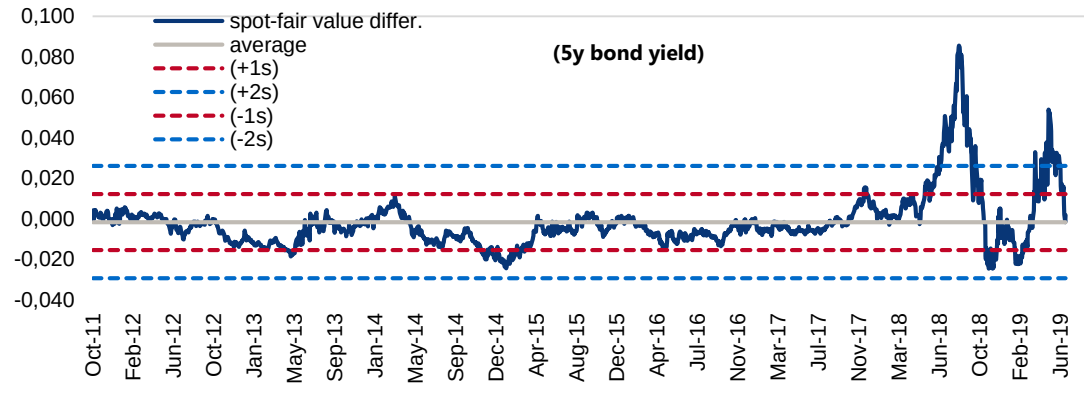
Current monetary stance supports the carry advantage of TRY



Foreign investors reduced their local bond positions significantly



Bond yields trade close to our fair value calculations

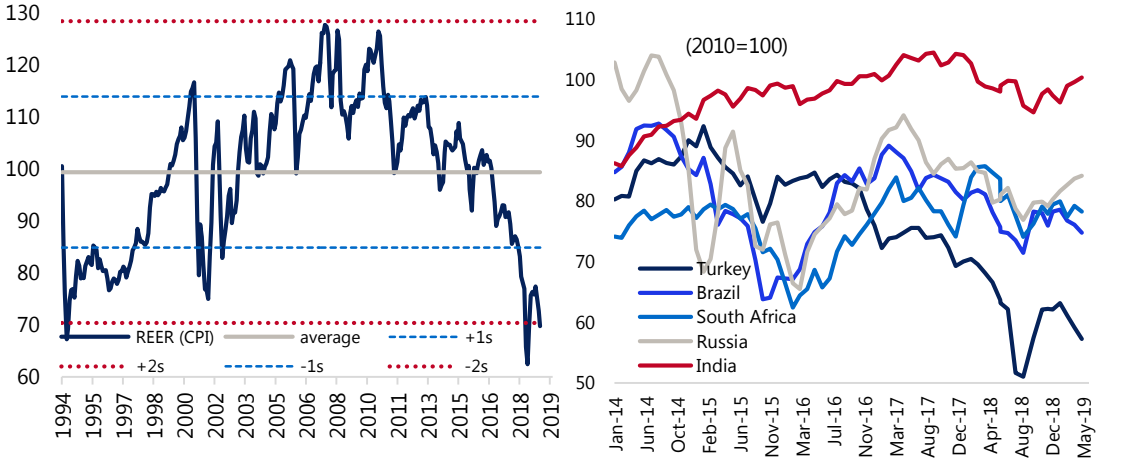


Source: CBT, Bloomberg, BRSA, Tacirler Investment

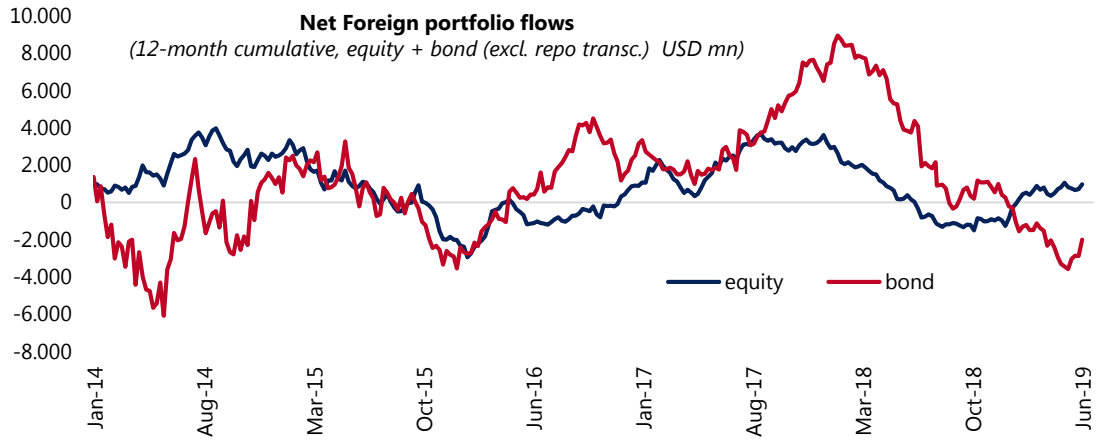
Local Currency

Weak and volatile

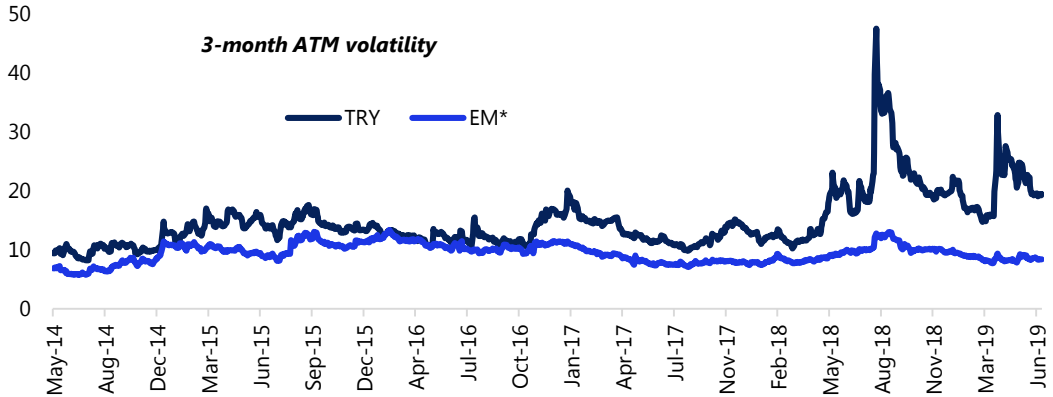
REER is oscillating at around -2x standard deviation



Weak foreign portfolio flows has been weighing on the FX liquidity

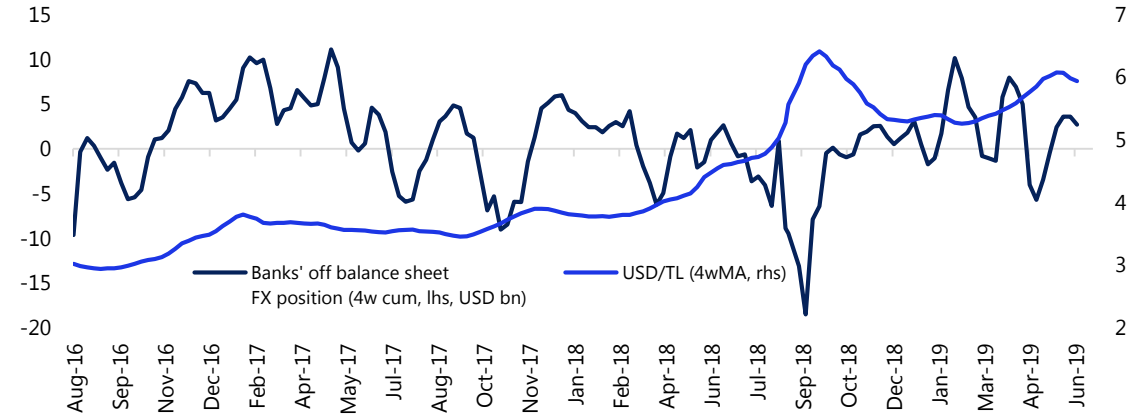


TRY has followed a more volatile pattern compared with EM currencies



*JP Morgan EM Volaility Index

TRY appreciated slightly in line with the recovery in carry positions

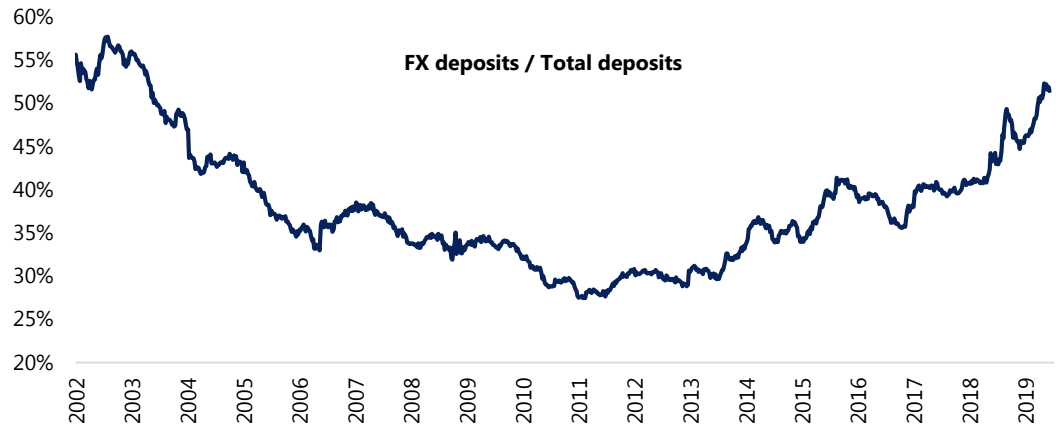


Source: CBT, BIS, Bloomberg, Tacirler Investment

Dollarization *(currency substitution)*

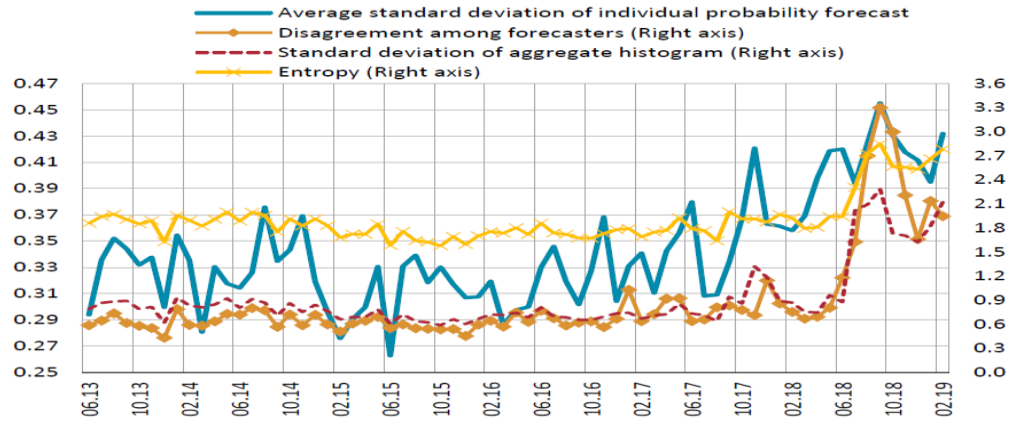
Confidence to the TRY has been eroding

The dollarization in the economy has gained pace starting from 2013

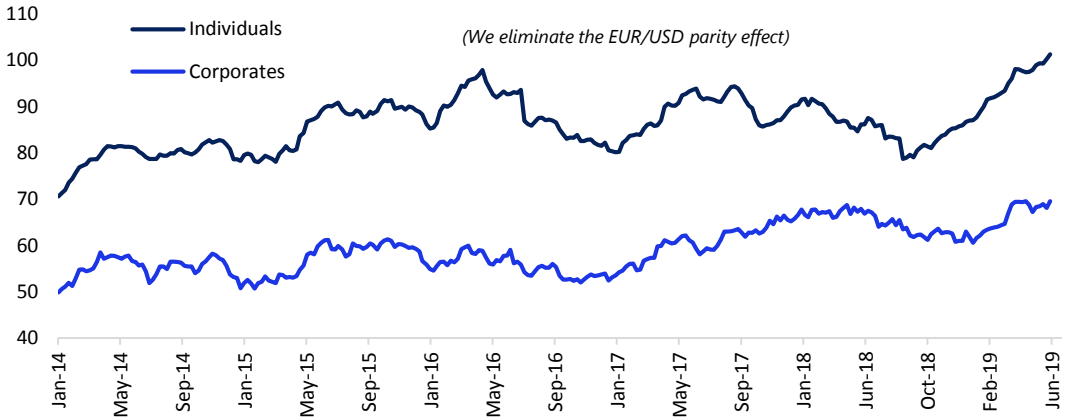


Measures of Inflation Uncertainty*

*** Source: Central Bank of Turkey, Working paper – Measuring Inflation Uncertainty in Turkey : WP No:19/12**

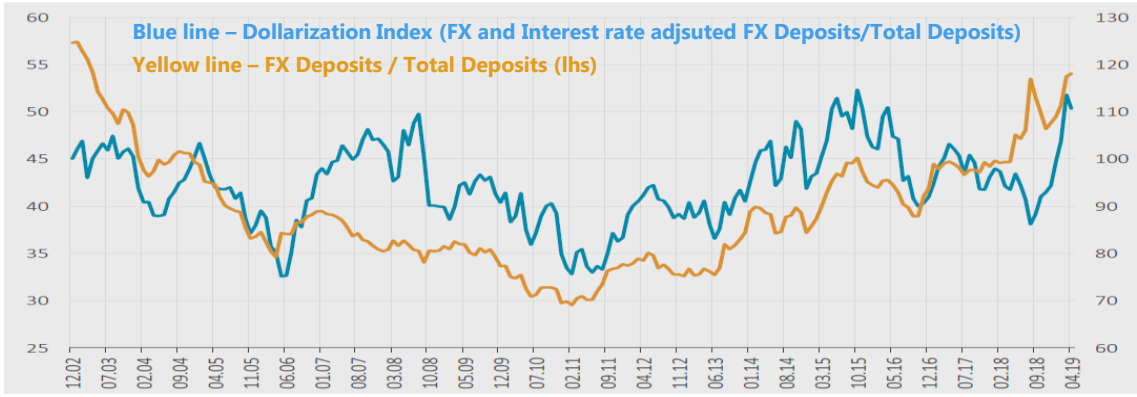


Households has been adding to their long FX positions since last August



FX and Interest rate adjusted dollarization*

***Source: Central Bank of Turkey, Financial Stability Report, May 2019 : Page 34**



Source: CBT, Tacirler Investment

Macro Forecasts*

Turkey at a glance

	2014	2015	2016	2017	2018	***2019F***	***2020F***
Real GDP Growth	5.2%	6.1%	3.2%	7.4%	3.0%	***-0.3%***	***2.0%***
Nominal GDP *(US$ bn)*	934.5	859.4	863.4	851.5	784.1	***753.3***	***758.7***
GDP per capita *(US$)*	12,085	10,996	10,935	10,602	9,632	***9,145***	***9,102***
CPI *(end-of-period)*	8.2%	8.8%	8.5%	11.9%	20.3%	***15.0%***	***11.0%***
CPI *(average)*	8.9%	7.7%	7.8%	11.1%	16.3%	***16.0%***	***13.5%***
CAD *(US$ bn)*	-46.5	-32.2	-33.0	-47.4	-27.6	***-4.5***	***-12.0***
CAD / GDP	-5.0%	-3.8%	-3.8%	-5.6%	-3.5%	***-0.6%***	***-1.6%***
USD / TL *(end-of-period)*	2.32	2.91	3.54	3.81	5.27	***6.30***	***6.82***
Basket / TL *(end-of-period)*	2.57	3.05	3.62	4.18	5.65	***6.77***	***7.47***
USD / TL *(average)*	2.19	2.72	3.02	3.65	4.84	***5.85***	***6.58***
Basket / TL *(average)*	2.55	2.87	3.18	3.88	5.23	***6.24***	***7.13***
CBT's weighted average cost of funding *(simple, eop)*	8.3%	7.5%	8.0%	8.5%	24.0%	***20.0%***	***17.0%***
10y bond yield *(end-of-period)*	9.4%	10.8%	11.4%	11.5%	17.7%	***17.1%***	***15.7%***

** Tacirler Investment estimates*

Source: CBT, Treasury, Bloomberg, TURKSTAT, Tacirler Investment estimates

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