Turkey Economic Outlook

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1. Editorial

The global economic activity, although moderating somewhat, has continued to perform positively during recent quarters. Robust figures were realised in advanced economies, especially in Europe, as the improvement has been broad-based across both demand components and countries, and standing above 2% in annualised terms. Beyond, there is also some support from the Chinese economy. The US economy’s performance in the first quarter of the year was somewhat worse than expected, even though the key growth drivers have not substantially changed. Accordingly, moving slowly with the monetary policy normalisation process accompanied by a better growth outlook in developing economies backed by the higher than expected performance of China. All this has calmed the financial markets down so far, reducing their overall volatility. For net importer countries like Turkey, lower than expected energy and commodity prices is good news.

The Turkish economy’s “V” shaped recovery is well alive and the pace of the recovery gained momentum with the recent 5% GDP growth in 1Q, thanks to the acceleration in net exports, public spending as well as solid private consumption. Our monthly GDP indicator suggests a similar growth in 2Q supported by fiscal and macroprudential stimuli provided by the Credit Guarantee Fund. The carry over for the second half of the year is wide (if the economy repeats the 5% growth in the 2Q, even zero quarterly growth rates during the rest of the year will result in a 5% growth for the whole year), thus posing our activity forecasts risks clearly on the upside. Overall, a faster than expected growth rate during the first half impels us to upgrade our 2017 GDP growth forecast from 3% to a high but still cautious 5% growth rate in 2017.

The inflationary pressures will start to moderate as the increasing demand pressures would be compensated by lower energy prices and the slightly better performance of the Turkish lira. Consumer price inflation started to recede after a peak in April with favorable base effects, a slight withdrawal in core prices and depressed energy prices. Although coming back to one-digit levels, inflation will remain elevated until the end of the year. We maintain our 2017 year-end inflation forecast of 9.0%.

The high level of inflation and the Federal Reserve’s (FED) more hawkish tone will maintain the Central Bank (CBRT) tight stance throughout the second half of the year, waiting for clearer signs of price moderation to return to a more neutral policy. The CBRT’s sizable tightening has helped to stabilize the exchange rate but inflation expectations remain far from anchored and the inflation rate is staying clearly above target. The CBRT will continue to rely on the Late Liquidity Window facility (LLW) to maintain its tight stance. Anyhow, once inflation starts to ease off, the CBRT is likely to allocate an increasing amount of liquidity through the rest of its instruments in order to reduce the average funding cost.

The Government’s countercyclical measures and the Credit Guarantee Fund started to pay off during the second quarter. Annual credit growth increased substantially during the second quarter and the public balance has already started to deteriorate. We expect the budget deficit to GDP ratio to increase to 2.1% in 2017. We believe that as long as the economy enters in a period of higher economic growth and employment recovery consolidates gradually a greater prudence in the implementation of anticyclical measures should be imposed.

The rest of the risks are balanced. The FED remains stuck to its initial plans, which will challenge the EM Central Banks in as far as changing interest rates and maintaining exchange rates under control. Beyond this, the end of the uncertainties following the April referendum and the current high momentum of economic recovery would create room for the Government to focus on economic reforms. On the other hand, the usual challenges still persist. The new election cycle and complex geopolitical region are still key issues to be monitored.
2. Global outlook

Robust and steady global growth, with some rebalancing across major areas

The world economy has been picking up in recent quarters with growth rates of 1% QoQ; although it has tended to stabilise. Global confidence is clearly positive, especially in the advanced economies, showing robust figures. World trade growth has recovered swiftly from the very low levels of the middle of last year and only seems to have slowed somewhat in April and May. All of this has also led to a recovery in industrial activity and investment globally.

This positive dynamic is a consequence of the prime driver of the recent expansion - the economic policy stimulus of the Chinese economy- that has driven growth in other Asian countries and in turn in the rest of the world economy. Other drivers of the global cyclical pattern, such as extremely accommodative monetary policies in most of the advanced nations, fiscal policies that have recently generally been neutral or expansionary and relatively moderate commodity prices, have also helped the global recovery. Financial markets have also been calm and have not suffered persistently from sources of political tension; the latest, the presidential elections in France.

This improving environment, which is mainly affecting the advanced economies is being accompanied by a certain rebalancing from the United States towards Europe, both in terms of activity (negative surprises in the United States earlier in the year and positive ones in the Eurozone). In addition, on the political front with the US administration’s difficulties in pushing through measures compared to the outcome of elections in Europe that had threatened to cast doubts over the euro project. In contrast, the performance of Emerging Economies has been asymmetrical, with a slower than expected exit from the recession of net commodity exporters, such as Latin America, and better performance from those experiencing positive terms of trade.

This environment of positive growth is currently accompanied by moderate inflation levels. Whereas deflation risks appear to have been overcome, the glut of liquidity in markets because of very expansionary monetary policies has not translated into an acceleration of inflation. This is because of the overhang of unused capacity (especially of labor) seems to be putting the brake on any substantial pressure from wages and core inflation, while the delay and, to some extent, reversal of oil prices in recent months has dampened price expectations and headline inflation rates.

Calm financial markets and normalisation of monetary policies

The tone in financial markets has been upbeat, with volatility at historic lows in spite of the persistent economic, political and geo-political uncertainty, as well as the correction to expectations of a fiscal impulse in the United States. As a result, long-term interest rates have remained anchored, partly correcting the rises in previous quarters, while the dollar has interrupted its firming course. This financial climate of low volatility and interest rates, and a weaker dollar combined with a better economic environment has boosted equities and the financial assets of
emerging markets. European assets, including the euro, have also become more appealing. Following the French elections and better economic performance in Europe, capital inflows into the Eurozone have turned around.

The big question is whether the markets are being too complacent, particularly bearing in mind that the major central banks are moving forward in the normalisation process. Even though the tone of monetary policy is still accommodative, in the last quarter, in tandem with the improvement of the economy, steps were taken to prepare the markets for a gradual withdrawal of stimuli.

The US Federal Reserve (Fed) has hiked interest rates twice in 2017; reaching 50 basis points overall, and has announced and outlined a plan to gradually reduce its balance sheet. From now until year end the Fed intends to carry out one more 25bp hike, probably in December, and embark on a “passive” course of action (i.e. by not renewing overdue assets) and steady scaling down the balance sheet, which it is likely to start in October. Even so, in the absence of robust growth and with very restrained price and wage inflation, market expectations are not aligned with those of the Fed (which are more bearish). In any case, shrinking official rates will make it more challenging to ease monetary policy in Emerging Markets.

The European Central Bank (ECB) is holding interest rates unchanged (the refi rate at 0% and the deposit rate at a negative level of -0.40%), as well as sticking to the asset purchasing programme (currently at 60bn euros per month). Nonetheless, the ECB is more confident about the strength of growth and considers that the risk of deflation has disappeared, which has given rise to the first changes in its forward guidance. In June the ECB removed its downward bias as regards rates, which is interpreted as a first step on the long road of normalisation. We expect that, the ECB will take a further step by announcing a reduction in its purchasing of assets (i.e. tapering) at the September meeting, which would be implemented from January 2018 onwards. Assuming no change in the exit sequence, interest rate rises would take place by late 2018. Here, a good communication strategy is key to avoiding tensions in financial markets, especially since they have been rather sceptical about any imminent normalisation.

We maintain a stable growth forecast in 2017-18, with risks still on the downside

Our new forecasts imply that global growth will stay at 3.3% for 2017 and 3.4% for 2018, with an upward revision for both China (in both years) and Europe (in 2017). The latter is due to a better-than-expected first half of the year, whereas our estimate for the United States has been slightly revised downwards due to a poorer than expected performance in the first quarter, as well as greater difficulties in getting expansive fiscal measures and undertaking reforms approved. In Latam, deteriorating commodity prices this year and heightened domestic uncertainty in several countries have meant that exiting the recession is taking longer than had been foreseen. These forecasts indicate that in the coming quarters the emerging economies should make up ground on the advanced countries and China, which has led the recent upturn.

The drivers behind the recent pick-up will remain in place, albeit with slight variations: monetary policies will gradually enter into a process of normalisation, while fiscal policies will remain relatively neutral or
expansionary. Oil prices, which have slowed down their progression to long term equilibrium levels (USD60/bbl) due mainly to increased supply factors (from producer countries such as Libya, Nigeria and the United States), are set to continue their rising course. The flurry of politically-related events (elections in Germany and Italy, Brexit negotiations, initiatives geared towards closer integration in the European Union, the political agenda in the United States, and the electoral cycle in LatAm in 2018) could influence economic confidence and the situation in the markets, although these seem to be having less of a long-lasting impact.

Figure 2.1 Regional GDP forecasts (YoY, %)

Source: IMF and BBVA Research

Figure 2.2 World GDP growth (QoQ, %)
Forecasts based on BBVA-GAIN

Source: BBVA Research
3. Turkey Economic Outlook

Economic activity remained strong in 2Q

Economic activity strengthened yet for another quarter, and Turkey GDP grew by 5% in 1Q thanks to the acceleration in net exports, robust public spending as well as a still solid growth rate in private consumption growth. Government stimulus seems to have helped households wipe out the negative effects of the volatility in the financial market throughout the quarter and has engaged the private sector in the recovery of the business cycle. In addition to the solid performance in private consumption, robust government expenditure led the overall consumption contribution to reach 4.4pp in this period. Private investment remained weak, which is particularly visible in the contraction of machinery investment. Specifically, the improvement in the services sector contributed to the production side of GDP growth with 3.5pp.

As economic activity strengthening above initial expectations, our monthly GDP indicator is also signaling a similar growth trend in 2Q with a growth level close to 5%. The unfavorable calendar effect due to the shift of the Ramadan holiday this year will somewhat slow-down economic activity; however, GDP growth might be even stronger in 2Q as industrial production (IP) has already risen by 5%, YoY in the April-May period. Rapid credit growth thanks to the Government’s Credit Guarantee Fund and intensified fiscal stimulus were the main factors behind the high momentum in 2Q. If these factors finally materialise, the economic recovery will gain momentum in the second half of the year.

Figure 3.1 GDP Growth by Expenditure Composition (% annual contribution)

Figure 3.2 Garanti-BBVA Research Monthly GDP (3MA, YoY)

Source: TURKSTAT, BBVA Research and Garanti Research

Source: BBVA-Garanti Research Monthly GDP Model, Turkstat
The strong growth performance and improvement in overall economic activity started to pay off in the labour market as well from the beginning of the year, and the unemployment rate fell gradually down to 11.3% (SA) in April from December's reading of 11.9%. Job creation was observed in all subsectors. The improvement in the service sector presented the most significant rise in performance among these sectors with an increase of around 320K in employment.

**Inflation started to recede but only marginally**

After reaching 11.3% in March, consumer inflation got to its peak of 11.9% in April. A favorable base impact on food inflation with a slight withdrawal in core prices and plummeting energy prices started to help the headline inflation by then, but the improvement has proved to be only marginal so far, as it reached 10.9% as of June.

Food inflation and cost shocks, which are still alive and pushing up prices, stemming from the exchange rate pass-through continued being the prominent factors that kept inflation at high levels. Year-to-date food inflation climbed up to 8.9% in the first half of the year (vs. 0.3% during the same period last year), driving yearly food inflation to 14.6% by June. Meanwhile, core inflation eased only slightly to 9.2% due to the extension of tax cuts on durable goods and the methodological change assigning fixed weights to the clothing and footwear group. Despite the declining energy inflation on top of lower prices, the trend in core inflation remained high due to second round effects of exchange rate depreciation, sticky service inflation on cost-push factors and the failure to contain inflation expectations (at highest levels since December 2008).

**Figure 3.3 Turkey: Annual Inflation**

![Graph showing annual inflation rates from 2013 to 2017 for CPI, Food&Beverage, Energy, I Index](image)

Source: TURKSTAT, BBVA Research and Garanti Research

**Figure 3.4 Turkey: Core Inflation & USD/TRY (YoY)**

![Graph showing core inflation and USD/TRY (YoY) from 2013 to 2017](image)

Source: TURKSTAT, BBVA Research and Garanti Research
Hawkish stance of the Central Bank against inflationary pressures

The high level of inflation and the volatility of emerging markets financial conditions stemming from uncertainties on the expected FED stance, led the CBRT to maintain its tight stance throughout 2Q. The Central Bank reinforced the hawkish tone in its June meeting by overlooking the expected disinflationary impacts of the fall in energy prices and partial correction in food prices in the summer months.

Since the third week of January, the CBRT has been funding the markets through a combination of O/N lending (9.25%) and the Late Liquidity Window (12.25%). Almost 90% of CBRT funding has been via the Late Liquidity Window (LLW) facility since the start of 2Q. This has made the LLW, once an extraordinary monetary policy tool, the most relevant interest rate in the CBRT’s monetary policy framework. **So far this year, the CBRT has raised the average funding rate by 370 basis points, from 8.3% at the start of the year to almost 12% as of July, preventing the lira weakening any further.**

Thus, the CBRT managed to reduce the volatility of Turkish financial assets contributing to the stabilisation of the Turkish Lira at a level of 3.5-3.6 against the US dollar, which was also supported by reduced political uncertainties after the referendum in April. As inflation and inflation expectations remain high, the need to maintain the tight monetary policy stance is reinforced until inflationary pressures clearly diminish.

The positive risk appetite towards EMs was also supportive in 2Q. **The yield curve continued to be negatively sloped as a result of the high level of inflation and the CBRT’s monetary tightening.** Although inflation is expected to stay at double digits until the end of the year, still lower risk premiums (despite the deterioration) have kept the long end of the yield curve downward. On the other hand, the more hawkish tone of global central banks since July has resulted in a sell-off in global bond markets, which has led the yield curve to shift upwards marginally at both ends in recent weeks.
In order to boost economic activity, the Turkish authorities implemented a Credit Guarantee Fund backed by the Treasury with a limit of up to TL250bn (around 9% of GDP). So far roughly 160TL bn (6% of GDP) has been used, of which near 90% of the credits have been used by SMEs (mostly in manufacturing and service sector activities). There is still uncertainty about the final impact but credit growth reacted sharply and the FX adjusted loan growth rate accelerated significantly to 18% in June, from below 10% at the end of last year.

Procyclical measures continued to widen the budget deficit in 2Q17

The Government continued to stimulate growth via procyclical measures, while revenue generation performance was only moderate in 2Q17 mainly due to tax cuts. Although recovering domestic demand and the extension of the tax amnesty have started to back revenues since May. According to our calculations, the budget deficit to GDP ratio increased to 2.0% by June, while the primary balance to GDP ratio reached -0.2% of GDP, down from 0.3% by 1Q and 0.8% at the end of last year.

Although total tax revenues improved in 2Q mainly on top of corporate tax revenues (thanks especially to banks), total revenues stayed depressed because of sizably lower privatisation revenues compared to the same period of last year. Revenue collection from tax amnesty reached almost TL 6bn, 2% of the total revenues in the first half of the year.

On the expenditure side, though still high, non-interest expenditure decelerated in 2Q, mostly due to the Government’s scale back in current transfers and investment expenditures. All in all, total revenues were up by 8.8% in annual terms in the first half of the year, marginally surpassing the Government's whole year target of 7.9%; while total expenditures grew by 18.5%, remarkably higher than the whole year target of 10.5%. Despite the higher than expected revenue collection from the tax amnesty and improving domestic demand, tax cuts and lower privatisation revenues (TL 5.9bn vs. TL 10bn in the first half of this year and last year) led to the generation of lower revenues.
The current account deficit deteriorated on energy and gold imports

The current account deficit (CAD) increased to USD 35.3bn in May from USD 32.7bn at the end of 1Q (to around 4.3% of GDP from 3.9%). While this increase was mainly due to higher energy bill and gold imports, the ongoing solid performance of exports and the gradual recovery in the tourism sector were the factors that contained the deterioration in the current account deficit in this period. Excluding net energy and gold, the deficit improved to USD 3.9bn by May from roughly USD 5bn at the end of 1Q, reflecting the effect of both supportive external demand and still modest import demand despite the high momentum in economic activity.

On the financing side, portfolio flows became the prominent factor thanks to the external debt issuance of both the Treasury and the banks (roughly a total of USD 6bn in April-May). This current account financing is equilibrated not only with portfolio inflows (34% of the financing), but also net foreign direct investment and other investments (deposits and external credit lines) comprised 26% and 4% of the financing on a 12-month cumulative basis. Net errors and omissions were positive with a 9% share, while the CBRT reserves also contributed by taking a 26% share in the same period. Both the banking sector and the real estate sector continued to reduce their long-term external borrowing, as the 12-month cumulative long-term external debt rollover ratio stood at 103% for banks and 123% for the non-financial sector as of May.
Base effects and robust initial performance signal significant growth in 2017

The robust growth of 5% YoY recorded during the first quarter has maintained its momentum. A first insight from industrial production (IP) and other high frequency indicators reflects that the path of recovery has remained robust and the economic recovery has broadened to the rest of the sectors. The IP accelerated to 5% in the period from April-May from 2.1% in 1Q, and the rest of the sectors by not relying exclusively on the automotive and electricity sectors as in 1Q has supported the growth rate. According to our monthly GDP indicator (with 26% information by June), the GDP growth in 2Q will maintain at least a similar growth rate, close to 5%.

During the third quarter the economic recovery will peak supported by Government stimuli (including some current tax reductions and other incentives), the Credit Guaranteed program, and the recovery of tourism, lower political uncertainty and extraordinary positive base effects. (If the economy grows 5% in 2Q, the economy will grow at least 5% in 2017 even with zero quarterly growth rates in 3Q and 4Q).

All in all, taking into account the recent high momentum, the improvement in the production of sub-sectors across-the-board and favourable base effects in 3Q, we are revising our 2017 GDP growth estimate significantly upwards from 3% to 5%, with there still being risks on the upside.
Headline inflation will remain at double digits until December’s fall

Inflation will moderate but will remain high. The Government’s decision not to hike taxes on tobacco will help the headline consumer inflation fall below 10% in July, but this effect will later reverse in August due to the reversal of base effects on food. Core inflation will worsen in September-October due to the methodological change assigning fixed weights to the clothing and footwear group, as well as the still high level of inflation in the service sector. The deceleration of inflation will become evident at the end of the year (particularly in December).

To sum up, we maintain our 2017 year-end inflation forecast at 9.0%. The narrowing output gap thanks to the recovery in domestic demand and a supply credit shock from the credit guarantee program will be compensated by lower energy prices in international markets, tighter than initially expected monetary policy and the decision to not raise taxes or administrative prices in the rest of the year.

…which will require the CBRT to remain tight in the rest of the year

We expect the CBRT to maintain its tight monetary policy stance and to continue with the extraordinary late liquidity window facility as a regular policy tool until a sizable correction in inflation is realised. After still falling in July, we expect annual inflation to stay around at least 10-10.5% until December. We assume that the CBRT should maintain real interest rates in positive territory (at least 1%) to anchor inflation expectations according to our models, thus maintaining this stance until inflation declines to at least the upper bound of the inflation target. Our end of the year average funding cost estimate has been revised upwards by 75 bp to a level of 10.25%.

We expect the CBRT to maintain such a policy stance in the short term by only managing the daily available TL liquidity in the market. Reducing the weight of the LLW facility in its daily funding would allow the CBRT to ease
monetary conditions gradually towards the end of the year, if global financial conditions remain supportive and headline inflation recedes towards single digits as we forecast.

The budget deficit will widen but will be lower than previously expected

As clearly seen in the first half of the year, the Government’s intensified countercyclical measures will further increase the budget deficit in the second half, but this increase will be much lower compared to our previous estimation on the back of the economy’s robust performance and the higher than expected revenue collection from the tax amnesty. Sizable public spending to boost private demand and postponed social security insurance premium collection will likely continue to generate a deficit at least in the short term. On the other hand, some upside risks remain for the following years as delayed contingent liabilities pose some negative risks if they materialise.

We expect the budget deficit to GDP ratio to increase to 2.1% in 2017 (down from our previous estimate of 2.5%) from 1.1% in 2016. This will generate a rise in the EU defined public sector debt to GDP ratio to 29.6% from 28.3% in 2016, according to our forecasts. Although still better than international standards, such as the Maastricht criteria, complacency should be avoided, in our view. The electoral cycle will start soon (next elections should take place in 2019) and entering the political uncertainty game with a significant deterioration would pose important extra risks. Thus, the rapid path of economic recovery should be accompanied by a gradual correction in the stimulus policy.

As increased budget deficit creates additional borrowing needs for the Treasury, where its debt rollover ratio rose to over 120% on average in the first half of the year (vs. the Treasury target for 2017 by 98%, with their own assumption of a 1.6% budget deficit to GDP ratio). The maintenance of a roll-over ratio over 100% will keep market interest rates under pressure, which will be also critical for the future monetary policy stance. Hence,
the more recent performance of economic activity, hinting at private demand recovery in a healthier way would help the Government bring back its fiscal expansion at least in the short term, in our view.

The current account deficit is expected to increase due to higher domestic demand

Although lower than initially expected oil prices and the relatively better performing tourism sector would imply that a lower current account deficit, potentially higher imports on top of improving domestic demand and credit expansion will offset this positive impact. Hence, we forecast a rise in the current account deficit from USD 32.6bn (3.8% of GDP) in 2016 to USD 39.3bn (4.8% of GDP) in 2017, bringing the CAD/GDP ratio above the structural current account deficit (4%, according to our estimations).

Table 3.1. Baseline Scenario: Forecast

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<td>Fiscal Balance (% of GDP)</td>
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</table>

Source: BBVA Research and Garanti Research
4. Balance of Risks

Economic and global market risks support the return to neutrality

The overall balance of risks is neutral. On the domestic front, the end of uncertainties after the April referendum should now lead the Government to focus on economic policies and reforms at least in the short term as the new election cycle is not so far away. The potential lagged impact of the rapid credit growth and ongoing fiscal stimulus will help support activity. However the still high unemployment rate levels will keep the Government alert since general economic confidence would continue to be one of the key points ahead of the new election cycle. This is why we are maintaining our 2018 GDP growth estimate close to the potential level. However, the risks are clearly on the upside as the carry-over from the statistical low base of last year and the higher than expected impact from policy stimulus could put growth clearly above potential. If this materialises, the government should start seriously restraining policy stimulus (particularly regarding fiscal and macroprudencial stimuli) to avoid financial stability woes in the coming years.

On the external front, financial tensions remain contained across the board, both in developed markets and in emerging ones, supported by both the positive economic data in major economies (including China, the EU and the US) and the fact that policy commitments in the US were not fulfilled ahead of the Presidential election. Accordingly, the sell-off in bond markets in recent weeks, triggered by the hawkish messages of global central banks to proceed with normalisation have increased volatility, but only marginally as markets continue to perceive this trend as mostly accommodative. Nevertheless, the likelihood of an immediate response of financial markets to the possible steps of the normalisation process with a faster than expected inflation path is still a potential source of market volatility.

Turkey’s political agenda is increasingly volatile as the new election cycle nears

While political uncertainty has diminished after the referendum and the security climate is calm, political parties will start to take positions for the next elections. With the referendum behind it, Ankara is now focusing on the next election cycle. There were three main developments in this quarter that may tend to affect political calculations for the next two years. First of all, with the approval of the new constitutional amendments President Erdogan became the chair of the ruling AK Party. Secondly, the main opposition secular CHP initiated a “Justice March” and vowed to continue protesting against the Government’s implementations after the FETO coup attempt and the referendum. And, last but not least, the political clash of figures within the nationalist MHP led opposition chaired by Meral Aksener to form a new center-right political party presumably before the year ends. In 2019, it is expected that there will be three elections and two of them (presidential and parliamentary) will be held together on November 3, 2019 according to the constitutional amendments. The third one is that for the local elections that would be held no later than March 2019, according to President Erdogan’s speeches.
Regarding domestic security, the country has been calmer due to Turkey's successful anti-terror operations against the PKK and ISIS inside the country and in northern Syria. This quarter, Turkey experienced no major terror attack and the calmer security environment helped market perception and the tourism sector recover.

**Middle East quagmire dominates Turkey’s foreign policy agenda**

The Middle East and Eastern Mediterranean regions remain highly volatile and Turkey’s involvement has gradually increased in what are still very complex scenarios. At the same time, Ankara has been successful in containing terrorist activities in Turkey, which has proved to be positive for market perception and the tourism sector. Yet, the possibility of an escalation in regional crises and the challenges in the EU agenda could underline any uncertainties ahead.

**ISIS is bleeding in Syria and Iraq but the post-war period will also be challenging.** Mosul, ISIS’s last main stronghold, was liberated on July 9. Meanwhile, the US-backed YPG (which was originally a PKK affiliate and considered to be a terrorist organisation by Turkey) surrounded Raqqa (the ISIS stronghold in Syria). Any terrorist attacks by Kurds in Turkey or close to the border can trigger more serious retaliation measures by Turkey. Whilst ISIS is losing ground, major powers that are operating on Syrian territory (Iran and Russia on the one side and the US on the other side) are competing to hold as much land as possible in order to have the upper hand in determining the country’s future. It is noteworthy that the race is fierce along the Iraq-Syria border. Alas, this competition fuels the risk of confrontation. Overall, uncertainties regarding the future of the war in Syria remain.

**The Qatar crisis is the new hot topic but fortunately, it is somehow being contained.** As the new generation is flexing its muscle in Saudi Arabia and is now ruling the country, and the war in Syria has summoned all major powers
into the region, the cards are being reshuffled, and some countries are feeling the spillover effects. Some Gulf countries including Saudi Arabia, the UAE and Egypt initiated a policy of containment against Qatar. Turkey and Iran’s material support (both of them have sent food supplies and Turkey has opened a military base and deployed troops in Qatar) and Washington’s diplomatic attempts (despite President Trump’s initial backing of Saudi Arabia against Qatar) helped the crisis maintain its non-escalatory level.

**The EU agenda continues on the table with many ups-and-downs.** Turkey’s EU bid has not progressed this quarter. No new chapters had been opened. However, cooperation between Ankara and Brussels is still being maintained. First of all, the EU and Turkey are still able to keep the refugee deal alive despite the verbal conflict that emerged during Turkey’s referendum process in April. Second, Turkey and the EU have initiated a new negotiation cycle to update the Customs Union. The partnership is still positive on economic and security issues. Yet, failed talks in Cyprus and Greek Cypriot unilateral gas drilling in the Eastern Mediterranean pose challenges for bilateral ties between Turkey and the EU.
## 5. Tables

### Table 5.1 Macroeconomic Forecasts: Gross Domestic Product

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<td>Brazil</td>
<td>0.5</td>
<td>-3.8</td>
<td>-3.6</td>
<td>0.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Eagles **</td>
<td>5.4</td>
<td>4.7</td>
<td>5</td>
<td>5.0</td>
<td>5.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>5.2</td>
<td>6.1</td>
<td>2.9</td>
<td>5.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>Japan</td>
<td>0.2</td>
<td>1.1</td>
<td>1</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>China</td>
<td>7.3</td>
<td>6.9</td>
<td>6.7</td>
<td>6.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Asia (exc. China)</td>
<td>4.2</td>
<td>4.5</td>
<td>4.6</td>
<td>4.1</td>
<td>4.4</td>
</tr>
<tr>
<td>World</td>
<td>3.5</td>
<td>3.3</td>
<td>3.2</td>
<td>3.3</td>
<td>3.4</td>
</tr>
</tbody>
</table>

*(p): projected

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Bangladesh, Brazil, China, India, Indonesia, Iraq, Mexico, Nigeria, Pakistan, Philippines, Russia, Saudi Arabia, Thailand and Turkey.
Forecast closing date: 12 July 2017.
Source: BBVA Research and IMF

### Table 5.2 Macroeconomic Forecasts: 10-year government bond yield

<table>
<thead>
<tr>
<th>(Annual average, %)</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017(p)</th>
<th>2018(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>2.53</td>
<td>2.13</td>
<td>1.84</td>
<td>2.36</td>
<td>2.62</td>
</tr>
<tr>
<td>Germany</td>
<td>1.22</td>
<td>0.52</td>
<td>0.13</td>
<td>0.44</td>
<td>1.14</td>
</tr>
</tbody>
</table>

*(p): projected

Forecast closing date: 12 July 2017.
Source: BBVA Research and IMF

### Table 5.3 Macroeconomic Forecasts: Exchange Rates

<table>
<thead>
<tr>
<th>(Annual average, %)</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017(p)</th>
<th>2018(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD-EUR</td>
<td>0.75</td>
<td>0.9</td>
<td>0.9</td>
<td>0.91</td>
<td>0.86</td>
</tr>
<tr>
<td>EUR-USD</td>
<td>1.33</td>
<td>1.11</td>
<td>1.11</td>
<td>1.1</td>
<td>1.17</td>
</tr>
<tr>
<td>GBP-USD</td>
<td>1.65</td>
<td>1.53</td>
<td>1.35</td>
<td>1.26</td>
<td>1.28</td>
</tr>
<tr>
<td>JPY-USD</td>
<td>105.82</td>
<td>121.07</td>
<td>108.82</td>
<td>113.7</td>
<td>118.5</td>
</tr>
<tr>
<td>CNY-USD</td>
<td>6.14</td>
<td>6.23</td>
<td>6.64</td>
<td>6.88</td>
<td>7.1</td>
</tr>
</tbody>
</table>

*(p): projected

Forecast closing date: 12 July 2017.
Source: BBVA Research and IMF
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This report has been produced by the Turkey, China and Geopolitics Unit
Chief Economist for Turkey, China and Geopolitics Unit
Alvaro Ortiz
alvaro.ortiz@bbva.com

BBVA Research
Group Chief Economist
Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Macroeconomic Scenarios
Miguel Jiménez
mjimenez@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Global Modelling & Long Term Analysis
Julían Cubero
julian.cubero@bbva.com

Innovation & Processes
Oscar de las Peñas
oscar.delaspeñas@bbva.com

Financial Systems & Regulation
Santiago Fernández de Lis
sferrandezdelis@bbva.com

Countries Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
anaru@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain & Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States of America
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serrano@bbva.com

Turkey, China & Geopolitics
Álvaro Ortiz
alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

China
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS: BBVA Research: Azul Street, 4, La Vela Building - 4 and 5 floor. 28050 Madrid (Spain). Tel.:+34 91 374 60 00 y +34 91 537 70 00 / Fax:+34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com

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