

# 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 antycyclical 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.

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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

**Deniz Ergun**  
denizerg@garanti.com.tr  
+90 212 318 10 59

**Asuman Kemiksiz**  
asumankem@garanti.com.tr  
+90 212 318 10 58

**Seda Güler**  
sedagul@garanti.com.tr  
+90 212 318 10 64

**Ali Batuhan Barlas**  
Alibar1@garanti.com.tr  
+90 212 318 10 67

**Yiğit Engin**  
yigite@garanti.com.tr  
+90 212 318 10 60

**Gizem Önen**  
Gizemon@garanti.com.tr  
+90 212 318 10 57

**BBVA Research**  
**Group Chief Economist**

Jorge Sicilia Serrano

**Macroeconomic Analysis**

Rafael Doménech  
r.domenech@bbva.com

**Global Macroeconomic Scenarios**

Miguel Jiménez  
mjimenezg@bbva.com

**Global Financial Markets**

Sonsoles Castillo  
s.castillo@bbva.com

**Global Modelling & Long Term Analysis**

Julián Cubero  
juan.cubero@bbva.com

**Innovation & Processes**

Oscar de las Peñas  
oscar.delaspenas@bbva.com

**Financial Systems & Regulation**

Santiago Fernández de Lis  
sfernandezdelis@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  
arubiog@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.serranoh@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