Turkey Economic Insight 2017

Executive Summary

Turkey's economy is in the midst of a strong upturn due to a USD60bn government backed credit guarantee fund (CGF), fiscal stimulus and robust external demand. Real GDP growth is projected to rise to 6.8% in 2017 as 80% of the CGF was utilised and moderate thereafter to 5.4% in 2018 and 5.3% in 2019 as stimulus measures are partly scaled back.

While external demand should be supportive of exports, imports could rise faster due to stronger domestic demand and higher oil prices. As a result, we project the current account deficit to widen slightly from 5.6% of GDP in 2017 to 5.9% in 2018 and 2019.

High inflation in 2017 was reflective of oil price gains, a weaker lira (TRY) and strong domestic demand due to stimulus measures. Inflation should gradually ease from 11.9% at end-2017 to 8.5% by end-2019 as the lira declines by less than it did in 2017 and as oil and other commodity prices are not expected to increase as much.

The Central Bank of the Republic of Turkey (CBRT) tightened policy in 2017 to prevent future rises in inflation. We expect rates to remain stable, which will push up real rates and further curtail inflation.

Banking sector growth is expected to remain robust on the back of the high lending growth from the CGF. Asset quality will continue to improve with non-performing loans expected to decline from 2.9% in 2017 to 2.8% by 2019. Profitability and capitalisation are expected to remain strong, the former reached a four-year high in 2017, with return on equity over 20% and the capital adequacy ratio rose to over 16% in 2017.

Contents

Economics Team
economics@qnb.com

Rory Fyfe
Acting Head of Economics
+974 4453 4643

Ashok Bhundia
Senior Economist
+974 4453 4642

Ali Jaffery
Economist

Nancy Fahim
Economist

Abdulrahman Al-Jehani
Research Analyst – Trainee

Editorial close: January 15, 2018

Table 1: Macroeconomic data and forecasts

	2016	2017e	2018f	2019f
Real GDP Growth (%)	3.2	6.8	5.4	5.3
CPI (%, end of period)	8.5	11.9	9.5	8.5
USD:TRY (avg)	3.0	3.6	3.9	4.0
Current account (% of GDP)	-3.8	-5.6	-5.9	-5.9
Fiscal balance (% of GDP)	-1.3	-1.5	-2.0	-2.0

Source: CBRT, Turkish Statistical Institute (TurkStat), Haver Analytics, QNB Economics

Table 2: Banking sector data and forecasts

	2016	2017e	2018f	2019f
Asset Growth (%)	11.8	19.3	15.3	15.2
Loan Growth (%)	16.7	20.8	16.1	15.1
Deposit Growth (%)	16.7	17.7	14.6	14.3
Loan-to-deposit ratio	120	123	124	126
Non-performing loans (% of total loans)	3.2	2.9	2.8	2.8

Source: CBRT, Haver Analytics, QNB Economics

USD60bn credit guarantee fund drove growth up from 3.2% in 2016 to a projected 6.8% in 2017

Growth to be driven by government stimulus

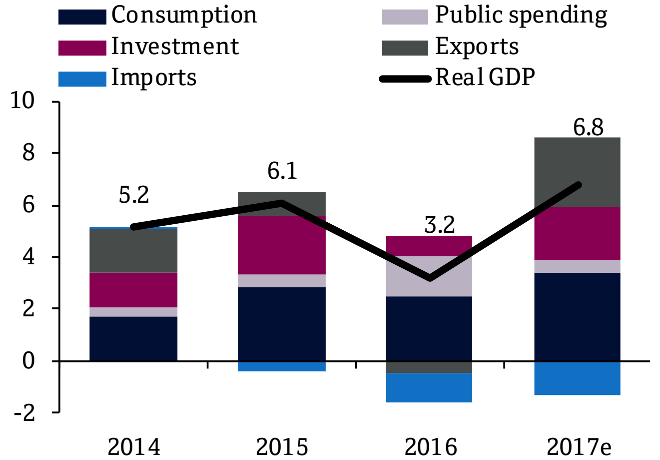
Background: A USD60bn government backed credit stimulus is the main driver of a surge in real GDP growth from 3.2% in 2016 to a projected 6.8% in 2017. The economy has also been helped by robust external demand, especially from the Euro Area, and a weaker lira supporting exports of goods and tourism, as well as by other fiscally supportive measures such as higher capital spending and reduced taxes on durable goods and property. The credit stimulus is part of the credit guarantee fund (CGF), through which the government guarantees loans to the private sector, creating a strong incentive for both borrowers and lenders to participate in the programme. By the end of 2017, 80% of the CGF had been utilised and loan growth reached 20.8% at end 2017.

Credit stimulus to be scaled back, but fiscal policy will continue to be expansionary and external demand should keep growth high in 2018-19

Outlook: Reduced credit stimulus is expected to cause growth to moderate but remain strong at 5.4% in 2018 and 5.3% in 2019. Most of the remaining 20% of the CGF is likely to be disbursed in 2018. Meanwhile, the loans made under the CGF in 2017 are expected to be rolled over. Hence, credit conditions should remain accommodative, but less so compared to 2017, and, therefore, growth should moderate. We expect the authorities to keep fiscal stimulus in place in 2018 and beyond. External demand should remain strong on the back of continued strength in the Euro Area, supporting tourism, exports and growth.

Chart 1: Real GDP

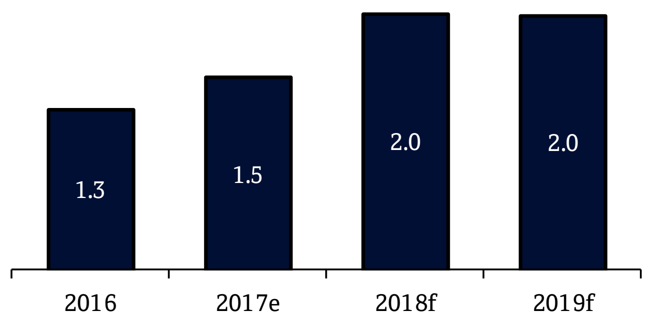
year-over-year, %



Source: TurkStat, Haver Analytics, QNB Economics

Chart 2: Fiscal Deficit

% of GDP



Source: TurkStat, Haver Analytics, QNB Economics

Lira to weaken gradually on current account deficit

Current account deficit to widen and Lira to gradually drop against USD

Background: TRY weakened due to elevated political risk in H2 2016, which prompted some capital outflows, and a widening current account deficit on account of strong import demand arising from the CGF. While the effect is gradually fading and capital inflows into Turkey strengthened in 2017, downward pressure on the lira from a higher current account deficit remains.

Outlook: The current account deficit is projected to widen from 5.6% of GDP in 2017 to 5.9% in 2018 and 2019 as high import demand is likely to continue reflecting strong growth and higher oil prices, although this will be partly offset by strong export growth. As a result we expect the lira to weaken as well, declining from an average of 3.6 per USD in 2017 to 3.8 and 4.0 in 2018 and 2019.

Inflation to ease over the medium-term

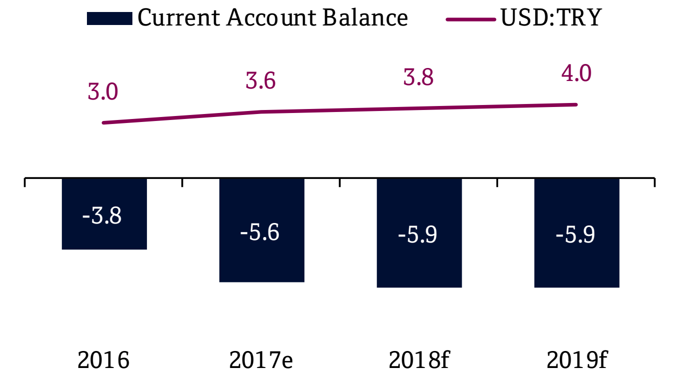
Inflation to peak in 2017 then gradually decrease on softer declines in the lira and slower growth in oil prices

Background: In 2017, inflation rose to 11.9% at end-2018, an increase from 8.5% at end-2016. The acceleration reflected weakness in the lira, higher oil and global food prices and a strong upturn in growth raising domestic demand-side inflationary pressures.

Outlook: We expect inflation to ease in 2018-19 for a number of reasons. First, the lira is expected to depreciate less in 2018-19 than it did in 2017 as oil and other commodity prices are not expected to increase as much as they rose in the past year. Second, as less credit stimulus is expected, domestic demand should moderate, resulting in less upward pressure on prices. Finally, the CBRT has been increasingly hawkish and is likely to keep monetary policy tight in order to curb inflation (see below). Consequently, we project that inflation will decline to 9.5% at end-2018 and 8.5% at end-2019.

Chart 3: Current account & Lira

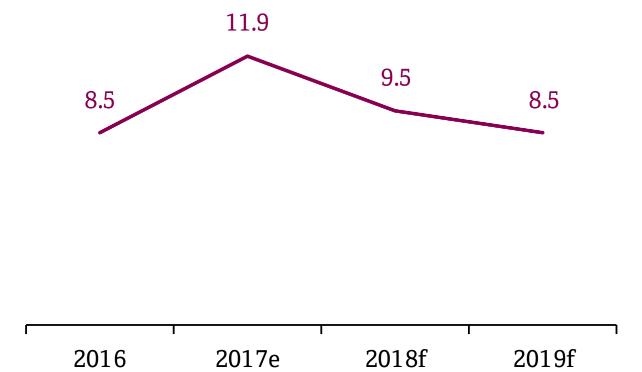
% of GDP & annual average per USD



Source: TurkStat, Haver Analytics, QNB Economics

Chart 4: Inflation

year-over-year, %, end of period



Source: TurkStat, Haver Analytics, QNB Economics

CBRT has tightened policy using unconventional measures

Monetary policy tightened unconventionally to support the lira while minimising the impact on growth

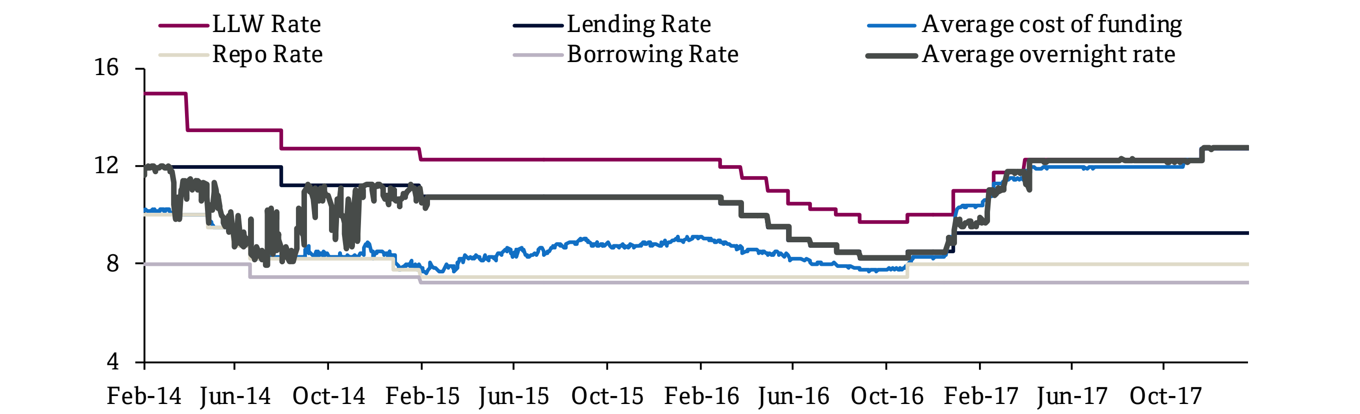
Background: The CBRT has adopted an unorthodox approach to monetary policy since 2014 in an effort to support the lira while minimising the impact of tighter policy on economic growth. The CBRT adopted a policy of using multiple interest rates in order to attract foreign depositors, draw liquidity into the banking system and shore up the lira. This began in 2014 when the CBRT started to provide some liquidity through its overnight lending rate (previously a ceiling for interest rates) in addition to the one-week repo rate, the official policy rate. The lending rate was 200 basis points (bps) above the repo rate at the time. This raised the overnight interbank rate, which increased the cost of shorting the lira as this involves borrowing the currency overnight and helped support the TRY. Nonetheless, the bulk of funding was still provided through the lower one-week repo channel keeping the average cost of funding for domestic loans down and supporting growth. The CBRT changed policy again in January 2017 when it restricted access to the lending rate, resulting in banks exclusively seeking funding at the late liquidity window (LLW), which was formerly a penalty rate. The LLW was 175 bps higher than the lending rate when this change came into effect. The CBRT went on to hike the LLW rate by 300 bps during 2017. By restricting access to funding channels rather than simply raising rates, the CBRT has tried to support the lira while delaying the exposure of residents to higher interest rates for credit.

Rates expected to remain unchanged, but this will be a tightening of policy in real terms

Outlook: We expect the CBRT to keep the LLW as its main policy rate, but to keep it on hold during 2018-19. Given that inflation is expected to decline, this will tighten policy by pushing up real rates.

Chart 4: Central bank interest rates

%



Source: CBRT, Haver Analytics, QNB Economics

Banking sector to be supported by credit guarantee programme

Loan and deposit growth soared in 2017 due to the credit guarantee programme and its positive growth impact

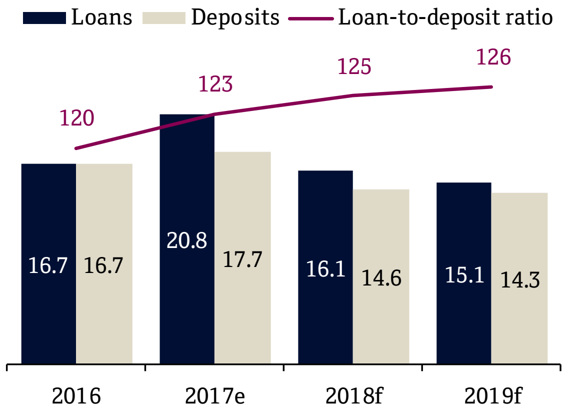
Background: Turkey's banking sector remains robust due to the CGF. The CGF has spurred high loan growth, which reached 20.8% at end-2017. Meanwhile, deposit growth has also risen reaching 17.7% in 2017 due to high nominal GDP growth. Overall, the banking sector is healthy. Non-performing loans have been on a declining trend in 2017, falling from 3.2% at end-2016 to 2.9% in November. Profitability reached a four-year high in 2017 with return on equity of 20.5% in Q2 and the capital adequacy ratio has risen from 15.6% at the end of 2016 to 16.4% in November 2017. Additionally, short-term foreign currency debt has remained stable, despite widening current and fiscal account deficits, as higher domestic deposit growth has displaced some foreign borrowing and international creditors have been encouraged by higher-than-expected growth, offering longer maturities on loans.

The banking sector has been strong with falling NPLs, high profitability and capital adequacy. Banks have effectively managed against FX risks

Outlook: As utilisation of the CGF is expected to be lower in 2018 and lower again in 2019, loan growth should slow progressively to 16.1% and 15.1%. However, as loans made under the CGF are likely to be rolled over, loan growth should still be relatively high. Deposit growth is expected to slow in line with lower nominal GDP growth to a still robust 14.6% in 2018 and 14.3% in 2019. As loan growth is forecast to be slightly higher than deposit growth, the loan-to-deposit ratio should rise from 123 in 2017 to 125 by end 2019.

Chart 5: Credit, deposits and liquidity

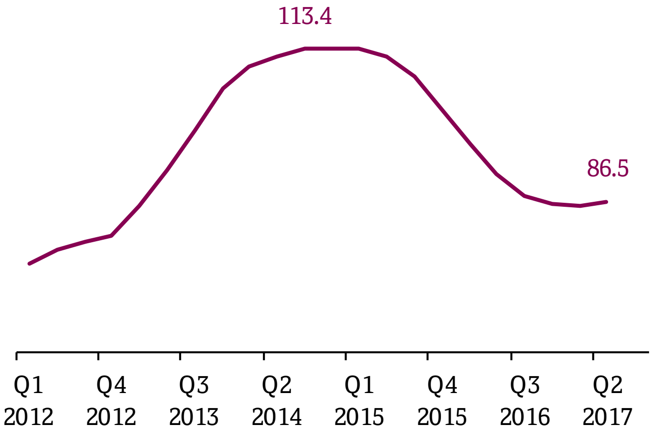
%, loan-to-deposit ratio reflects liquidity



Source: CBRT, Haver Analytics, QNB Economics

Chart 6: Short-term foreign currency debt

USD billion, four quarter moving average



Source: CBRT, Haver Analytics, QNB Economics

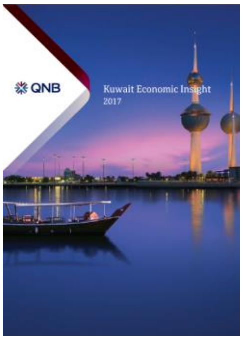
QNB Group Publications

Recent Economic Insight Reports

[Qatar - Dec 2017]

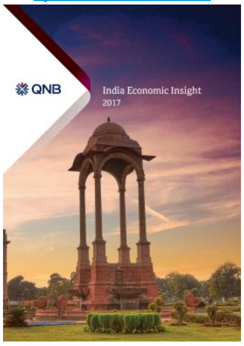
[Indonesia 2017]

[Singapore 2017]

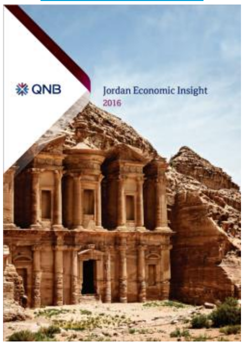


Kuwait 2017

Qatar - Apr 2017



India 2017



Jordan 2016

China 2016

Vietnam 2016

Indonesia 2016

Qatar Reports

Qatar Monthly Monitor

Recent Economic Commentaries

Oil prices to average USD60-65/b in 2018 on balanced market
Rising inflation expectations spook markets
IMF revises up global growth forecasts
Sub-Sahara Africa growth recovery set to continue in 2018
Strong demand is the main driver of the recent rise in oil prices
Our new SEA tracker suggests growth dipped in Q4 2017
Qatar GDP picks up in Q3
China's growth surprises in 2017 but likely to slow in 2018
Is the pickup in global growth sustainable?
OPEC likely to extend cuts due to higher output from non-OPEC
Qatari economy to prove resilient
Global trade recovery focused in EM Asia and the US
Emerging Market capital flows have rebounded in 2017
China remains the biggest threat to global financial stability
Japan's strong near-term growth obscures long-term challenges
Confidence in emerging markets grows
Why have oil prices recovered?
Is lower global inflation temporary?
China's "Belt Road Initiative" explained
Qatar retains its dominance in global LNG market
OPEC's 2018 dilemma

QNB International Branches and Representative Offices

China
Representative Office
Shanghai World Financial Center
9th Floor, Room 930
100 Century Avenue
Pudong New Area, 200120
Shanghai, China
Tel: +86 21 6877 8980
Fax: +86 21 6877 8981
qnb.com

France
Branch
65 Avenue d'lena
75116
Paris, France
Tel: +33 1 53 23 0077
Fax: +33 1 53 23 0070
QNBParis@qnb.com

India
Branch
G-1A, Ground Floor, 4 North Avenue
Maker Maxity, Bandra Kurla Complex
Bandra East
400 051
Mumbai, India
Tel: +91 22 62296300
Fax: +91 22 62296363
QNBIndia@qnb.com

Iran
Representative Office
No.17 Africa Highway
Navak building, 6th Floor, Unit 14
Tehran, Iran
Tel: +9821 88889814-22
Fax: +9821 88889824
QNBIran@qnb.com

Kingdom of Saudi Arabia
Branch
Hamad Building
King Fahad Highway
230108
Riyadh, KSA
Tel: +966 11 297 80 99
Fax: +966 11 297 80 98
info@ksa.qnb.com

Kuwait
Branch
Al-Arabia Tower
Ahmad Al-Jaber Street
Sharq Area, P.O. Box: 583
Dasman 15456 – Kuwait
Tel: +965 2226 7023
Fax: +965 2226 7021
QNBKuwait@qnb.com

Lebanon
Branch
Ahmad Shawki Street
Capital Plaza Building
Mina El Hosn, Solidere
11-210 Riad El Solh
Beirut, Lebanon
Tel: +961 1 762 222
Fax: +961 1 377 177
QNBLebanon@qnb.com

Mauritania
Branch
Al-Khaima City Center
10, Rue Mamadou Konate
P.O. Box: 2049
Nouakchott, Mauritania
Tel: +222 45249651
Fax: +222 4524 9655
QNBMauritania@qnb.com

Myanmar
Representative Office
No. 53, Strand Road #316
Strand Square Pabedan Township
Yangon, Myanmar
Tel: +95 1 2307371
Fax: +95 1 2307372
QNBMyanmar@qnb.com

Oman
Branch
QNB Building,MBD Area – Matarah
Opposite to Central Bank of Oman
P.O. Box: 4050, 112, Ruwi
Muscat, Oman
Tel: +968 2478 3555
Fax: +968 2477 9233
QNBOman@qnb.com

Qatar
Head Office
P.O. Box: 1000
Doha, State of Qatar
Tel: +974 4425 2444
Fax: +974 4441 3753
ccsupport@qnb.com
qnb.com

Singapore
Branch
Three Temasek Avenue
#27-01 Centennial Tower
39190
Singapore
Tel: +65 6499 0866
Fax: +65 6884 9679
QNBSingapore@qnb.com

South Sudan
Branch
Plot No 67
Port Road, Konyo-Konyo Market
P.O. Box: 587
Juba, South Sudan
Tel: +211 959 000 959
QNBSouthSudan@qnb.com

Sudan
Branch
QNB Tower – Africa Road
Street 17, Amarat
P.O. Box: 8134
Khartoum, Sudan
Tel: +249 183 48 0000
Fax: +249 183 48 6666
QNBSudan@qnb.com

United Kingdom
Branch
51 Grosvenor Street
W1K 3HH
London, UK
Tel: +44 207 647 2600
Fax: +44 207 647 2647
QNBLondon@qnb.com

Vietnam
Representative Office
Times Square Building
10th Floor 57-69F, Dong Khoi Street
Ben Nghe Ward District 1
Ho Chi Minh City, Vietnam
Tel: +84 8 3911 7525
Fax: +84 8 3827 9889
QNBVietnam@qnb.com

Yemen
Branch
QNB Building
Al-Zubairi Street
4310 Sana'a
Sana'a, Yemen
Tel: +967 1 517517
Fax: +967 1 517666
QNBYemen@qnb.com

QNB Subsidiaries and Associate Companies

Algeria
The Housing Bank for Trade and Finance
Associate Company
16 Rue Ahmed Ouaked – Dali Ibrahim
P.O. Box: 103
16 320 Dali Ibrahim
Alger, Algeria
Tel: +213 21918787
Fax: +213 21918881
info@hbtf.com.jo

Jordan
The Housing Bank for Trade and Finance
Associate Company
Parliament Street, Abdali
P.O. Box: 7693
Postal Code 11118
Amman, Jordan
Tel: +962 6 500 5555
Fax: +962 6 56781211
info@hbtf.com.jo

Syria
QNB Syria
Subsidiary
Al Abbassiyeen Square
P.O. Box: 33000
Damascus, Syria
Tel: +963 11 2290 1000
Fax: +963 11 44 32221
QNBSyria@qnb.com

Bahrain
QNB Finansbank
Subsidiary
Flat 51, 5th Floor, Unitag Hse, Bldg 150,
Rd 383, Block 315, Government Ave
P.O. Box: 2435
Manama, Bahrain
Tel +973 211322
Fax +973 211339
dstk@finansbank.com

Libya
Bank of Commerce and Development
Associate Company
BCD Tower, Gamal Abdel Nasser Street
P.O. Box: 9045, Al Berka
Benghazi, Libya
Tel: +218 619 080 230
Fax: +218 619 097 115
info@bcd.ly

Tunisia
QNB Tunisia
Subsidiary
Rue de la cité des sciences
P.O. Box: 320 – 1080
Tunis, Tunisia
Tel: +216 71 754 911
Fax: +216 70 728 533
qnb.com.tn

Egypt
QNB Al Ahli
Subsidiary
Dar Champollion, 5 Champollion St
Downtown 2664
Cairo, Egypt
Tel: +202 2770 7000
Fax: +202 2770 7799
qnbaa@qnbalahli.com

Palestine
The Housing Bank for Trade and Finance
Associate Company
Ramallah, AlQuds St., Padico Building
P.O.Box: 1473
West Bank, Palestine
Tel: +970 2 2986270
Fax: +970 2 2986275
info@hbtf.com.jo

Turkey
QNB Finansbank
Subsidiary
Esentepe Mahallesi Büyükdere
Caddesi Kristal Kule Binası No:215, Şişli
Istanbul, Turkey
Tel: +22245249651
Fax: +222 4524 9655
dstk@finansbank.com.tr

Indonesia
PT Bank QNB Indonesia Tbk
Subsidiary
QNB Tower, 18 Parc SCBD
Jl. Jend. Sudirman Kav. 52-53
Jakarta, 12190, Indonesia
Tel : +62 21 515 5155
Fax: +62 21 515 5388
corporate.communication@qnb.co.id

Qatar
Al Jazeera Finance Company
Associate Company
Salwa Road, Opposite to Medmak Bridge
P.O. Box: 22310
Doha, Qatar
Tel: +974 4405 0444
Fax: +974 4405 0445
info@aljazeera.com.qa

Togo
Ecobank Transnational Incorporated
Associate Company
20, Avenue Sylvanus Olympio
P.O. Box: 3302
Lomé, Togo
Tel: +228 22 21 72 14
Fax: +228 22 21 42 37
ecobanktg@ecobank.com

Iraq
Mansour Bank
Subsidiary
Al Wihda Area
district 14, building 51
Al Alawiya 3162
Baghdad, Iraq
Tel: +964 1 7175586
Fax: +964 1 7175514
info@mansourbank.com
mansourbank.com

Switzerland
QNB Suisse SA
Subsidiary
Quai du Mont Blanc 1
P.O. Box: 1785 – 1201
Genève, Switzerland
Tel: +41 22907 7070
Fax: +41 22907 7071
info@qnb.ch

UAE
Commercial Bank International p.s.c
Associate Company
3rd and 13th Floor, Festival Tower,
Dubai Festival City
P.O. Box: 4449
Dubai, UAE
Tel: +971 4 4023 000
Fax: +971 4 4023 737
cbiuae.com