

Turkey Business Forecast Report Q3 2014

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Abstracts

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Core Views

Although we have a positive outlook on Turkey's long-term growth, our real GDP growth forecasts reflect an expectation of below-potential growth in the years ahead. This will result from less abundant foreign capital inflows and slowing domestic credit growth, both key drivers of Turkey's economy. Political instability and social tensions will remain elevated in the run-up to general elections in 2015, weighing on business and consumer confidence.

With relatively healthy budget and debt dynamics, the government will provide a more pronounced fiscal boost to the economy. However, recent populist policy initiatives lead us to question the government's commitment to conservative fiscal management. While the government's debt load is low by regional standards, the private sector's rampant external borrowing in previous years has greatly increased macroeconomic risks.

After substantial widening of external imbalances in 2013, we expect Turkey's current account deficit to narrow only gradually in the coming years due to its dependence on imported energy. Turkey will remain reliant on short-term foreign capital inflows to cover the sizeable current account shortfall, leaving it prone to tightening global liquidity and shifts in international risk sentiment. A dovish central bank will keep inflation well above target and ensure a volatile growth trajectory.

A major corruption scandal and increased incidences of popular protest have highlighted the fact that major political challenges still face the country over the medium term. In particular, the ruling Justice and Development Party will take an increasingly unilateral approach as it struggles to maintain support, and will face growing and more

vocal public opposition, with the potential for further unrest. Moreover, Turkey faces a challenging foreign policy environment amid heightened regional tensions, and as the government attempts to cement its role as an economic and political power in the region.

Major Forecast Changes

We have revised up our 2014 real GDP forecasts for Turkey on the back of a strong Q114 growth reading. We now expect growth of 2.4% in 2014, from 1.5% previously.

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BMI Political Risk Ratings

Domestic Politics

Erdo?an Presidency All But Assured

Turkish Prime Minister Recep Tayyip Erdo?an will win the presidency in the August election and continue to dictate the policy agenda of the ruling Justice and Development Party. As such, we expect social tensions to remain elevated and caution that populist economic policies could begin to damage Turkey's reputation for prudent fiscal management.

Table: Political overview

Long-Term Political Outlook

Structural Changes To Continue

Turkey's moderate Islamist Justice and Development Party (AKP) will continue to press ahead with reforms to the country's political and social system for the foreseeable future. Although the AKP continues to enjoy broad popular support, there is growing and increasingly visible opposition from the traditional secular establishment that threatens to trigger a wider backlash. In terms of foreign policy, we expect Turkey to continue rebalancing its interests away from the West in favour of closer ties with the former Soviet Union and the Middle East and North Africa.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Weak Consumption Outlook Underpins Low Growth Forecast

We forecast real GDP growth in Turkey of 2.4% and 3.3% in 2014 and 2015 respectively, from 4.0% in 2013. Slowing capital inflows and a tightening of domestic credit conditions has led to a slowdown in domestic demand, and we expect decelerating private consumption to be the main driver of weaker growth, with net exports propping up total economic activity.

Table: GDP By Expenditure

Balance Of Payments

Pace Of Rebalancing To Slow Beyond 2014

Turkey's current account deficit will narrow to 6.0% in 2014, from 8.0% of GDP in 2013, on the back of weak imports and strengthening external demand. Beyond 2014, the pace of rebalancing will slow substantially as domestic demand accelerates, with the deficit remaining above 5.0% through 2018. Short-term investment inflows will continue to be the main source of deficit financing, implying that Turkey will remain vulnerable to destabilising periods of capital flight.

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Central Bank Policy Ensures Volatile Growth Trajectory

Abundant global liquidity will allow the Central Bank of Turkey to continue easing policy in H214. However, the bank will miss inflation targets both this year and next, perpetuating perceptions of a pro-growth bias and government influence. This implies little support from a policy perspective for Turkey's rebalancing process, ensuring a volatile growth trajectory and continued susceptibility to capital flight.

Table: Monetary Policy

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Fiscal Risks Growing

Turkey's public debt and deficit will remain at sustainable levels in the coming years even as the government plays a larger role in driving economic growth. That said, recent populist policy initiatives threaten Turkey's reputation for prudent fiscal management.

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Exchange Rate Policy

Lira To Resume Depreciatory Trend

The lira's recent run of appreciation against the US dollar is running out of steam, in line with rising US yields and domestic monetary easing. A wide current account deficit, sluggish external rebalancing and a fundamentally dovish central bank will keep the currency on a depreciatory path over the next two years.

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10-YEAR FORECAST PERIOD. KEY ECONOMIC POLICY AND INSTITUTIONAL

REFORMS IN THE MEDIUM TERM WILL BE NECESSARY TO SET THE GROUNDWORK

For productivity gains beyond 2015. Significant risks will remain, however, especially as underlying social tensions between secularists and moderate Islamists are unlikely to disappear in the next decade. This has contributed to our view that Turkey will not join the EU at any point over our forecast period.

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