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

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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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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.
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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

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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.
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Turkey will remain vulnerable to destabilising periods of capital flight.

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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: Monetar y Polic y

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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

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