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Turkey Business Forecast Report Q4 2013

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Abstracts

Core Views

We expect economic growth to accelerate modestly in 2014 and 2015, although our forecasts are well below consensus. A loss of investor confidence following recent social unrest and global financial market turmoil will slow capital inflows and cap the potential growth of Turkey's credit and consumption-driven growth model. With relatively healthy budget and debt dynamics, the government is in a position to provide a more pronounced fiscal boost to the economy.

However, we expect fiscal discipline to remain relatively high on the government's agenda, with monetary policy playing a more active role in supporting growth.

After substantial widening of external imbalances in 2013, we expect Turkey's current account deficit to narrow only gradually in coming years. Turkey will remain reliant on short-term foreign capital inflows to cover the sizeable current account shortfall, leaving it prone to shifts in international risk sentiment and leaving open the potential for financing crises.

Recent protests have highlighted the fact that major political challenges still face the country over the medium term. In particular, the government will struggle to secure a multi-party consensus on the process of writing a new constitution, and the ruling Justice and Development Party will face growing and more vocal public opposition, with the potential for further unrest. Moreover, Turkey faces a challenging foreign policy environment amidst heightened regional tensions as the government attempts to cement its role as an economic and political power in the region.

Major Forecast Changes

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We have revised down our 2014 and 2015 real GDP forecasts for Turkey on the back of tightening monetary conditions and our expectation for a less amenable global environment for emerging market growth. We now expect growth of 3.1% and 3.4% in 2014 and 2015 respectively, from 4.2% and 4.8% previously. Nevertheless, if the Turkish authorities are able to weather the rebalancing process and challenging external financing environment over the next few quarters, the country's long-term growth story remains an attractive one.

Key Risks To Outlook

The major risk to Turkey's macroeconomic trajectory stems from its external financing requirement. Turkey's large current account deficit and dearth of foreign direct investment inflows leaves the country vulnerable to external shocks and a major outflow of foreign capital. As such, while we see potential upside risks to our short-term forecasts, should global risk appetite pick up again we believe risks are weighted primarily to the downside.

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and monetary conditions tighten in coming quarters. We forecast real GDP growth of 2.8% in 2013 to accelerate only modestly to 3.1% and 3.4% in 2014 and 2015 respectively, well below consensus expectations.

Balance Of Payments

Financing Risks Remain

Turkey's current account deficit will widen to 6.9% of GDP in 2013, before moderating domestic demand and waning financial account inflows contribute to a gradual external rebalancing, bringing the deficit to 5.9% by 2015. However, in the context of a long-term decline in demand for emerging market assets, heightened investor perceptions of sovereign risk in Turkey and a loss of monetary policy credibility create a non-negligible risk of a financing crisis.

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Fiscal Policy

Fiscal Consolidation On Hold As Growth Slows

Although we remain broadly constructive towards Turkey's fiscal trajectory, we expect budget deficit consolidation to take a breather in 2014 and 2015 as revenue growth weakens and government expenditures prop up slowing economic growth. After falling to 1.9% of GDP in 2013, we forecast the budget deficit to reach 2.4% and 2.8% in 2014 and 2015 respectively.

TABLE: FISCAL POLICY

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Central Bank Gamble Won't Pay Off

Although the Central Bank of Turkey has indicated its rate hiking cycle has come to an end, it has not done enough to restore confidence in its monetary policy and stabilise the lira. With under three months of import cover, ongoing FX reserve sales will prove insufficient to stem capital outflows and lira depreciation, and we continue to believe a 50 basis point hike to its main policy rate will be necessary before end-2013.

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Weak Macroeconomic Outlook And Unrest Dent Infrastructure Growth

While the tough macroeconomic conditions and social tensions impacting Turkey have caused a downward revision to our short-term forecasts for the sector, a slew of high-profile projects, such as the awarding of Istanbul's third airport, the US$35bn Sino-Turkish high-speed rail venture and the progression of Turkey's nuclear power plants, continue to underpin our positive outlook for the Turkish construction sector. The weaker short-term economic growth forecast for Turkey, and the increased cost of credit for Turkish banks in light of the selloff of the lira, has caused us to drop our real

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