

Yapı Kredi Yatırım

Macro Thoughts: Summer is Coming December 2019

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Yeşim Sarışen

The Outlook –Short/Medium Term

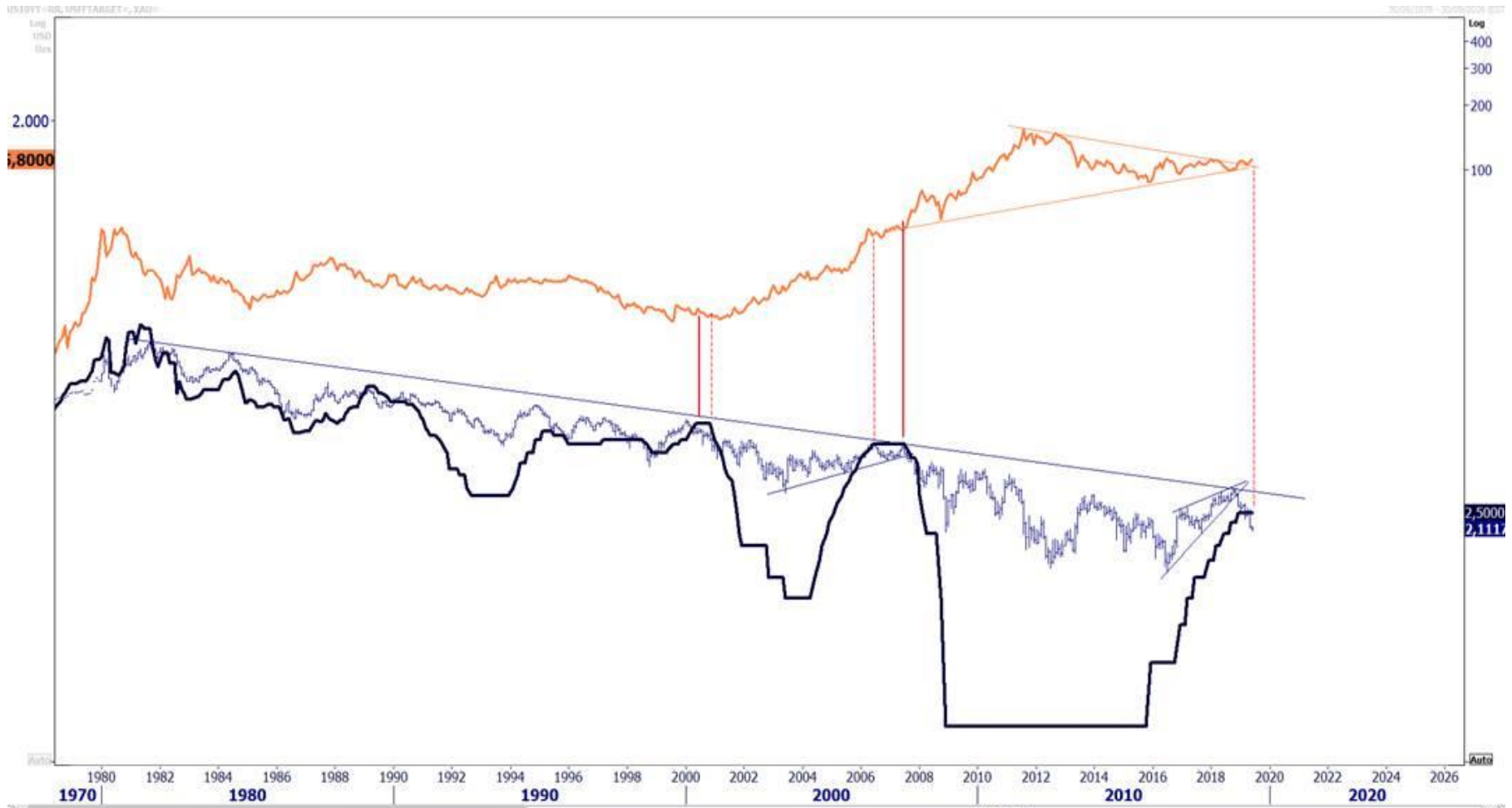
“In the depth of winter, I finally learned that within me there lay an invincible summer.” – Albert Camus

- Markets were pessimistic back in October. Things have changed: Turkish assets have performed extremely well and most major equity markets have risen after our contrarian piece (“Macro Thoughts - Turning more Positive, 15 October”) was published. Now it’s almost impossible to find a nonbeliever or a bear!
- The current global economic environment remains in Quad3 (slower growth/lower inflation), but the latest PMI reports on global manufacturing were a mixed bag but generally point to a rebound in growth. Specifically, manufacturing new orders appear to have troughed and with potential for decreasing uncertainties on trade tensions and Brexit- likely to boost corporate confidence which has been lagging consumer confidence- a cyclical rebound in growth and inflation due to lagged effects of oil and base effects looks likely.
- Thus, the global economic environment is likely to enter Summer/Quad1 (higher growth/higher inflation). This is a probability very few (especially bonds) seem to be ready and positioned for. If true, the quad change will have major implications for various asset prices.
- Last month we downgraded our tactical stance for global risk assets to neutral while keeping our tactical view on Turkish assets as neutral. Our theoretical short term model signals are bullish (100% long) Turkish equities and bearish (20% short SP500 futures) while flat for Gold and USD/TRY currently.

The Outlook –Short/Medium Term

- We maintain our neutral strategic stance across Turkish assets as well as global risk markets (both since March 2019). Gold remains our favorite investment asset since the start of the year.
- There are increasing signs that central banks around the globe are switching to a less activist but more symmetric reaction function with increasing tolerance towards higher inflation rates. For example, the Fed's hurdle for interest rate cuts is high however, the hurdles for hiking seem to have become even greater.
- Similar to the Fed, the ECB's strategic review, which will be initiated in January, should lead to a more symmetrical reaction function.
- The combination of increasing growth and a continued loose monetary policy should lead to higher inflation expectations, rising bond yields and a steeper yield curve. The growth backdrop for equity markets should remain friendly in 1Q but with probably increasing volatility and differentiation.
- Thus, cyclical sectors may be preferred to those low yield proxies. On a regional basis, EM should outperform DM.

Gold, Fed rate cut cycles and 10 UST yields



Gold (orange), Fed funds (black) and UST 10Y yields
Source: Reuters

EM and DM

- In 2018, MSCI Turkey declined by 42%, underperforming MSCI EM, MSCI World and S&P500, which registered returns of -16%, -10% and -6% respectively.
- 2019 year to date, S&P 500, MSCI World and MSCI EM up by 25%, 22%, %9.5 respectively, while MSCI Turkey increased by %3

MSCI Turkey, MSCI EM, MSCI World, S&P 500



Emerging markets

- 2019 year to date, MSCI EM increased by +8% underperforming S&P 500 index which registered returns of +23%.
- The outlook for EMs has shifted more positive recently. Dovish central banks and a China-US trade “truce” has played a big role.

MSCI: G7 and EM (August 2008=100)

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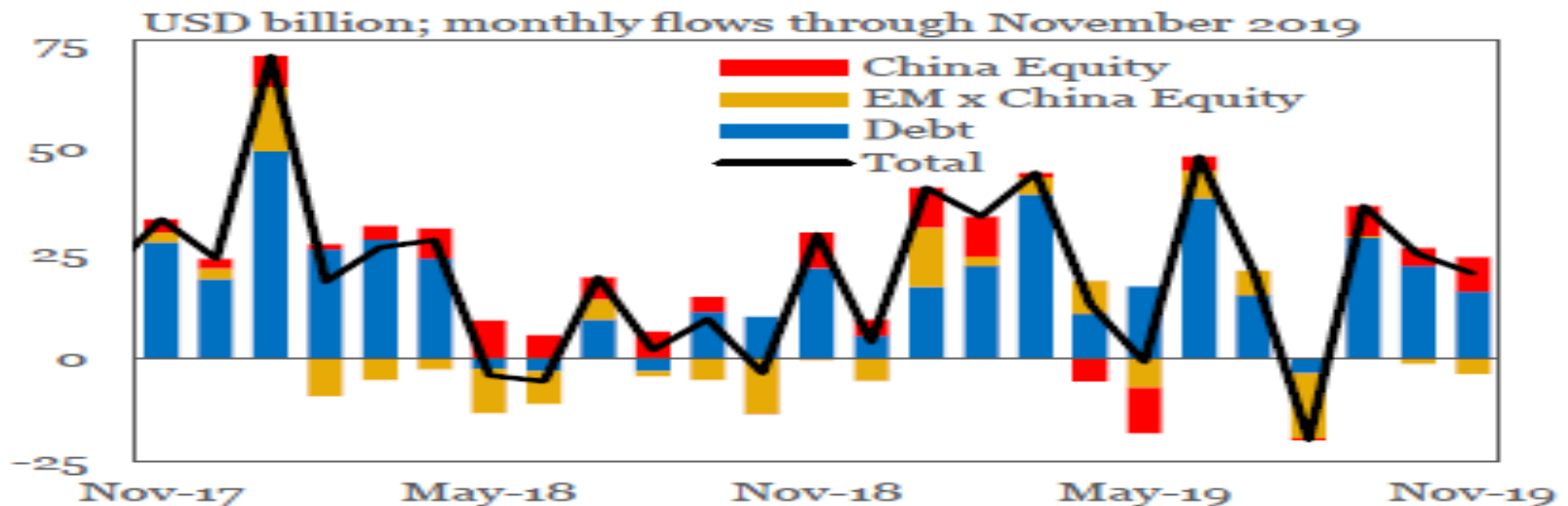


Source: Turkey Data Monitor

EM portfolio flows

- Portfolio flows to Emerging Markets were \$20.3 bn in November. (\$24.9 bn in October)
- Equity and debt flows were \$4.4 bn and \$15.9 bn, respectively. (October: +\$1.5 bn and +\$22 bn) But equity flows to EM x/China turned negative in November (-\$3.9 bn).
- Flows to emerging markets continued their recent recovery from the slump in August. Year-to-date, emerging markets have attracted inflows of \$261.3 bn, \$70 bn higher than over the same period in 2018 but \$90 bn lower than over the first 11 months of 2017.

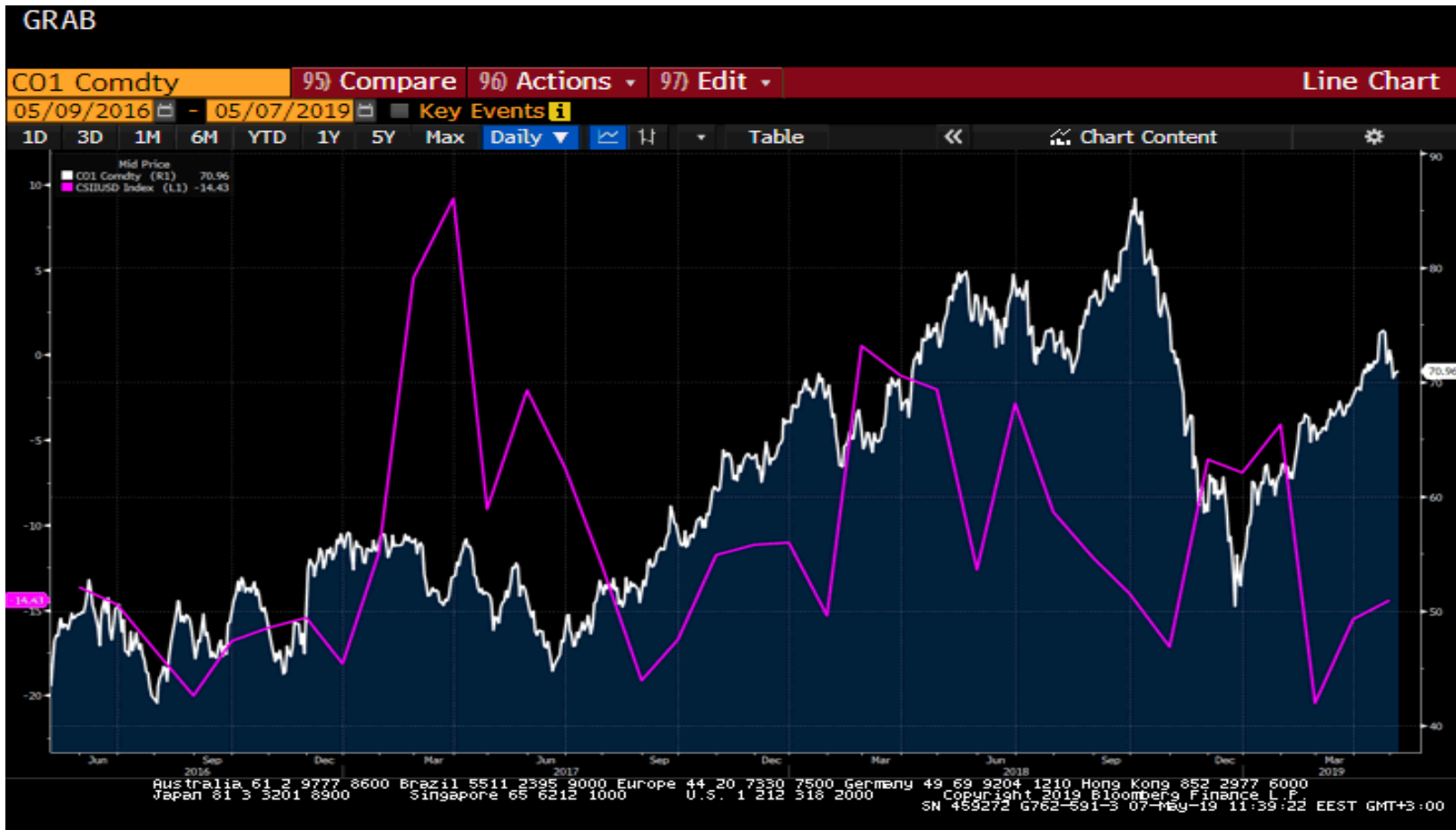
Exhibit 1. Net Non-Resident Portfolio Inflows to EMs



Source: Haver, IIF

Source: IIF

Oil and US inflation surprises

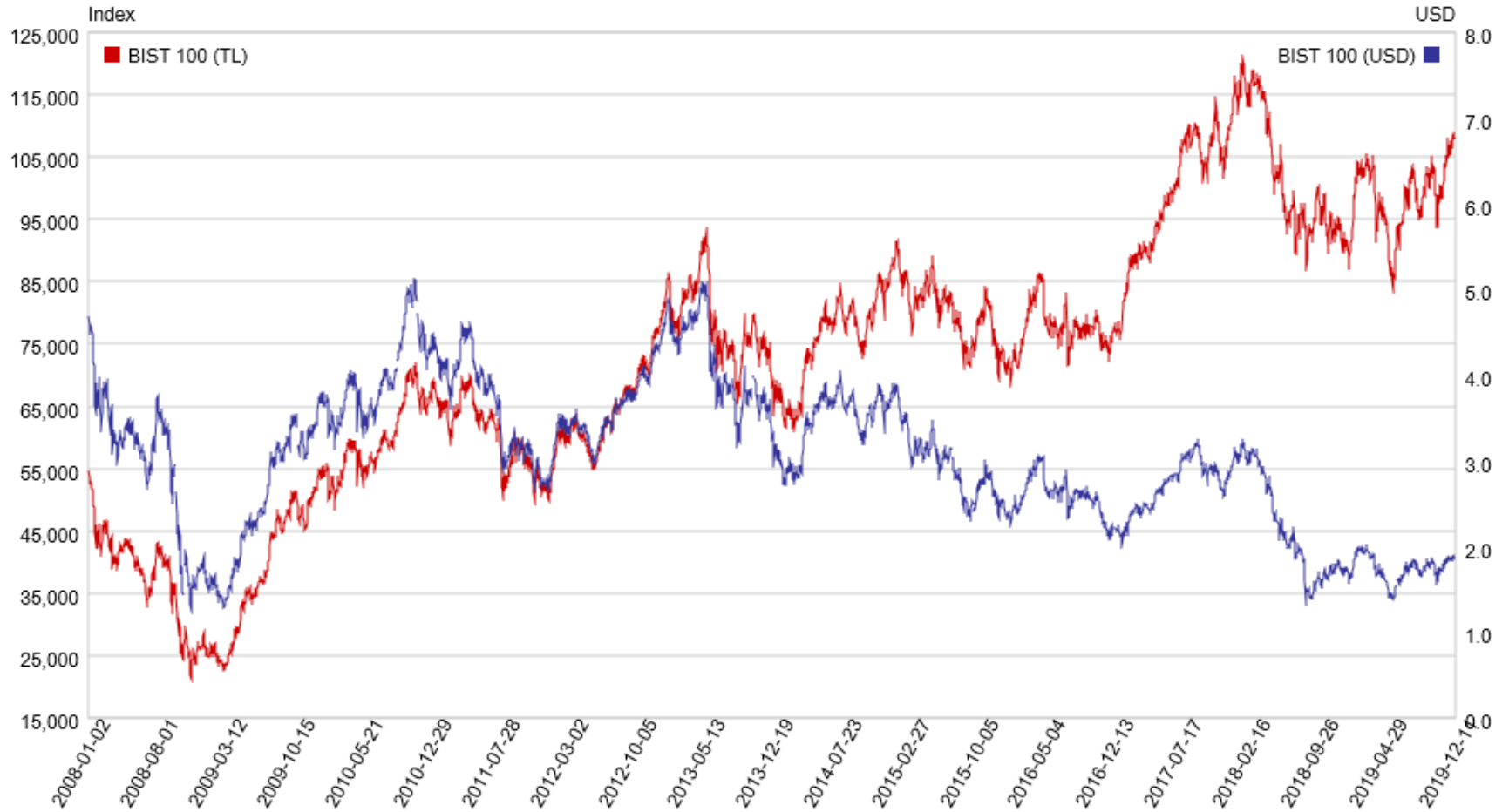


Source: Bloomberg, Brent (white) and Citi US Inflation Surprises Index

BIST-100

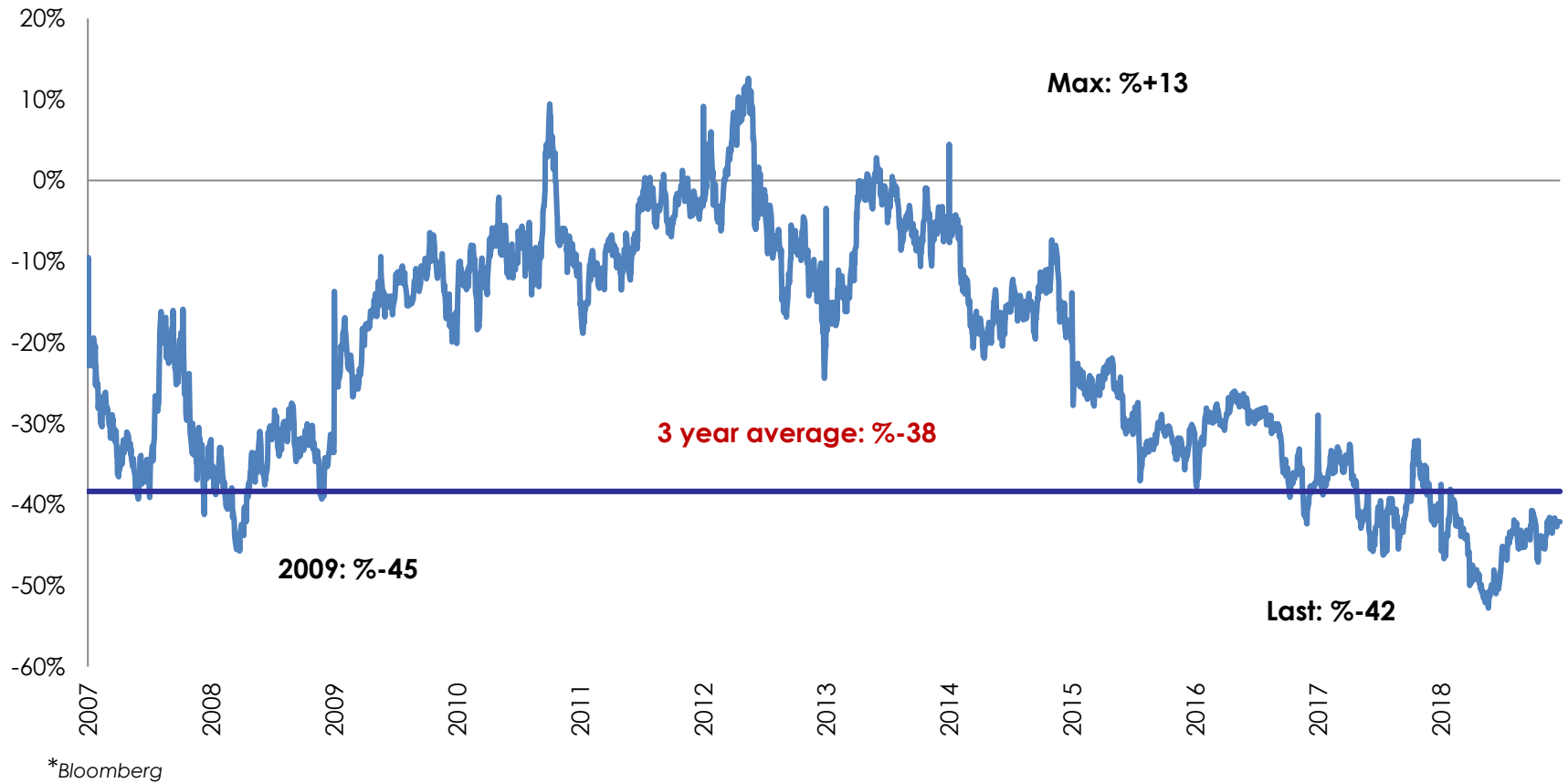
Borsa Istanbul

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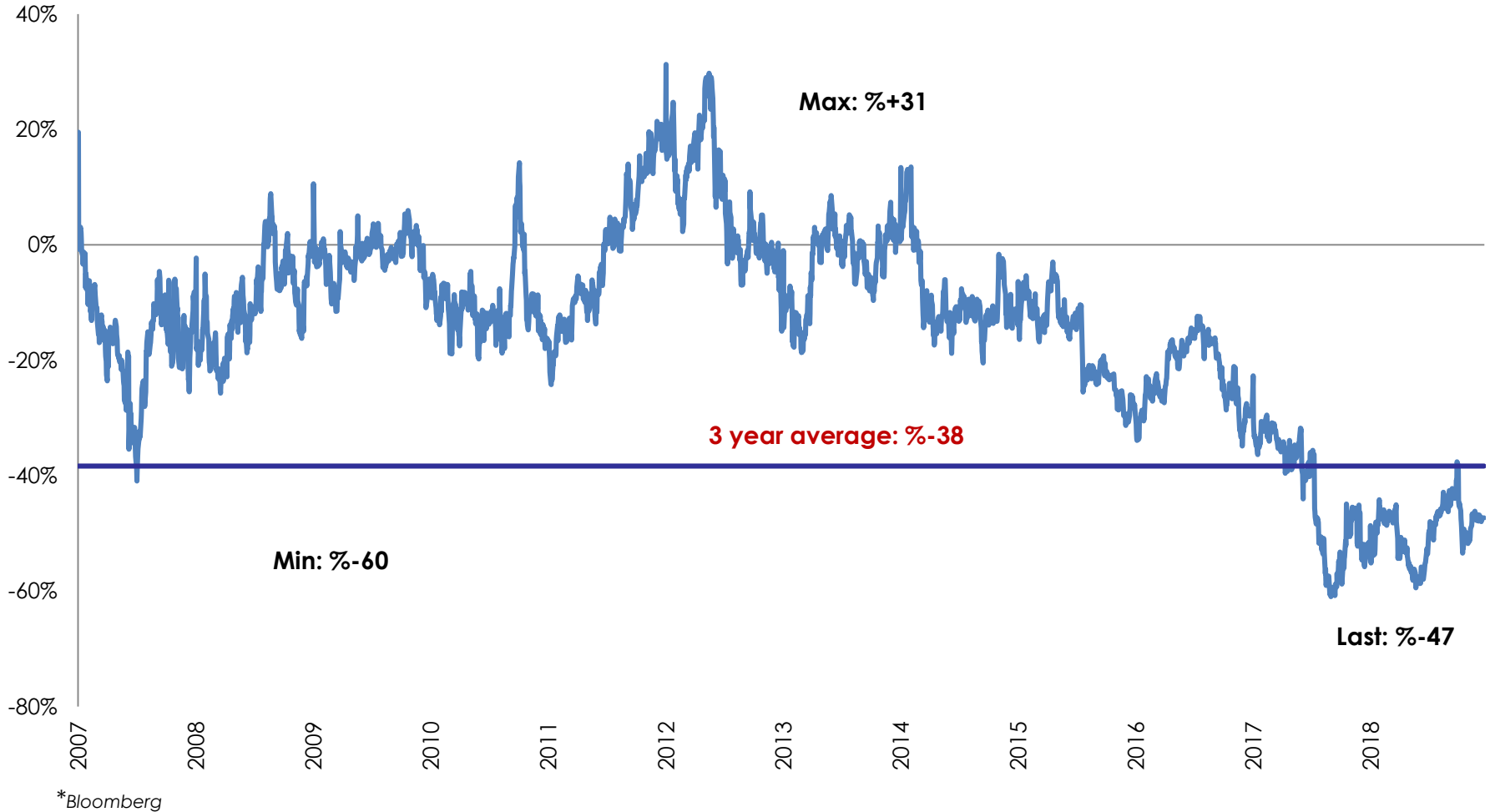


Source: Turkey Data Monitor

BIST 100 vs. MSCI EM Index premium/discount on P/E basis



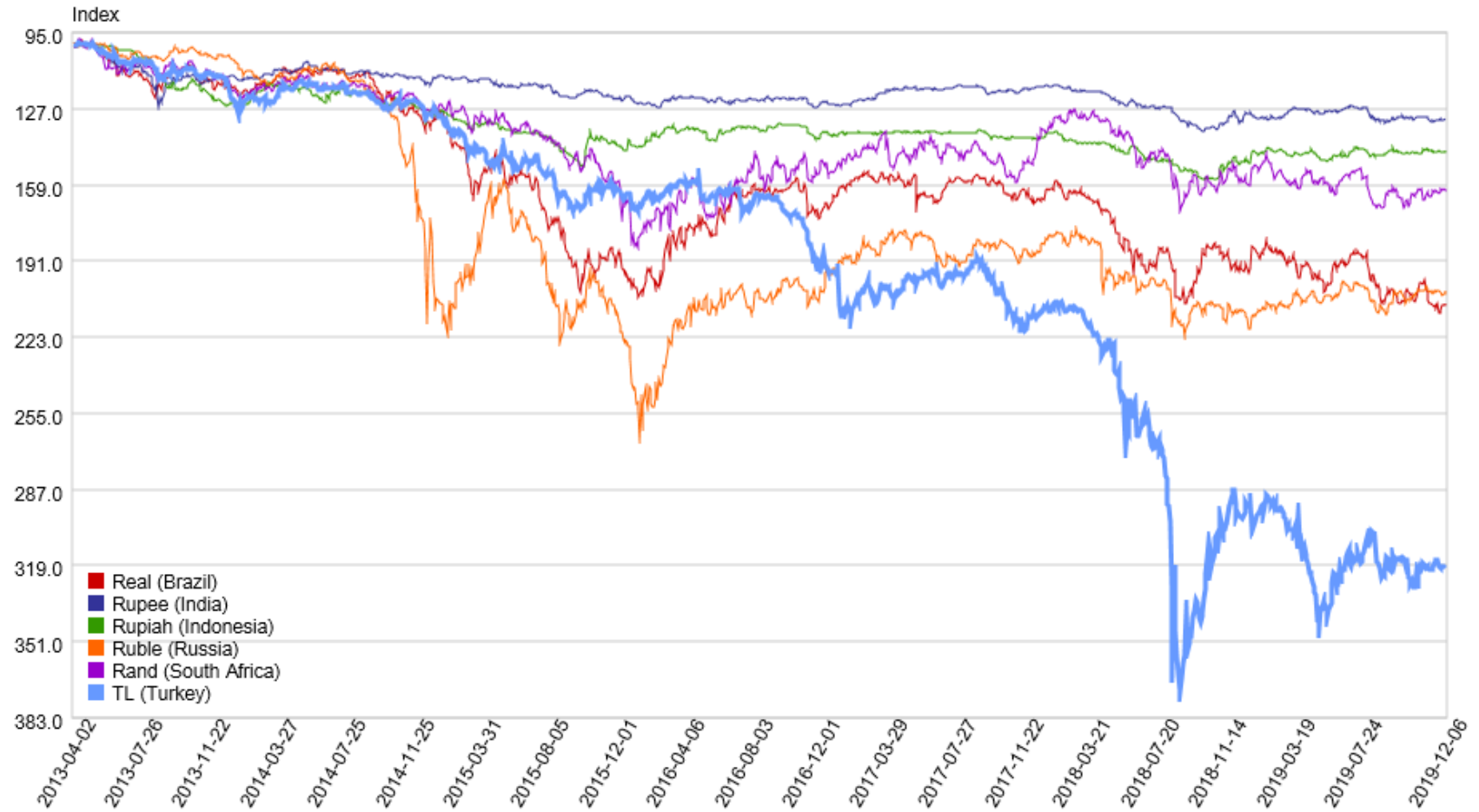
BIST Bank vs. MSCI EM Bank Index premium/discount on P/B basis



Turkish Lira

Selected Emerging Markets Exchange Rates (April 2013=100)

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Source : Turkey Data Monitor

10 year local benchmark rate

10-Year Benchmark Rate

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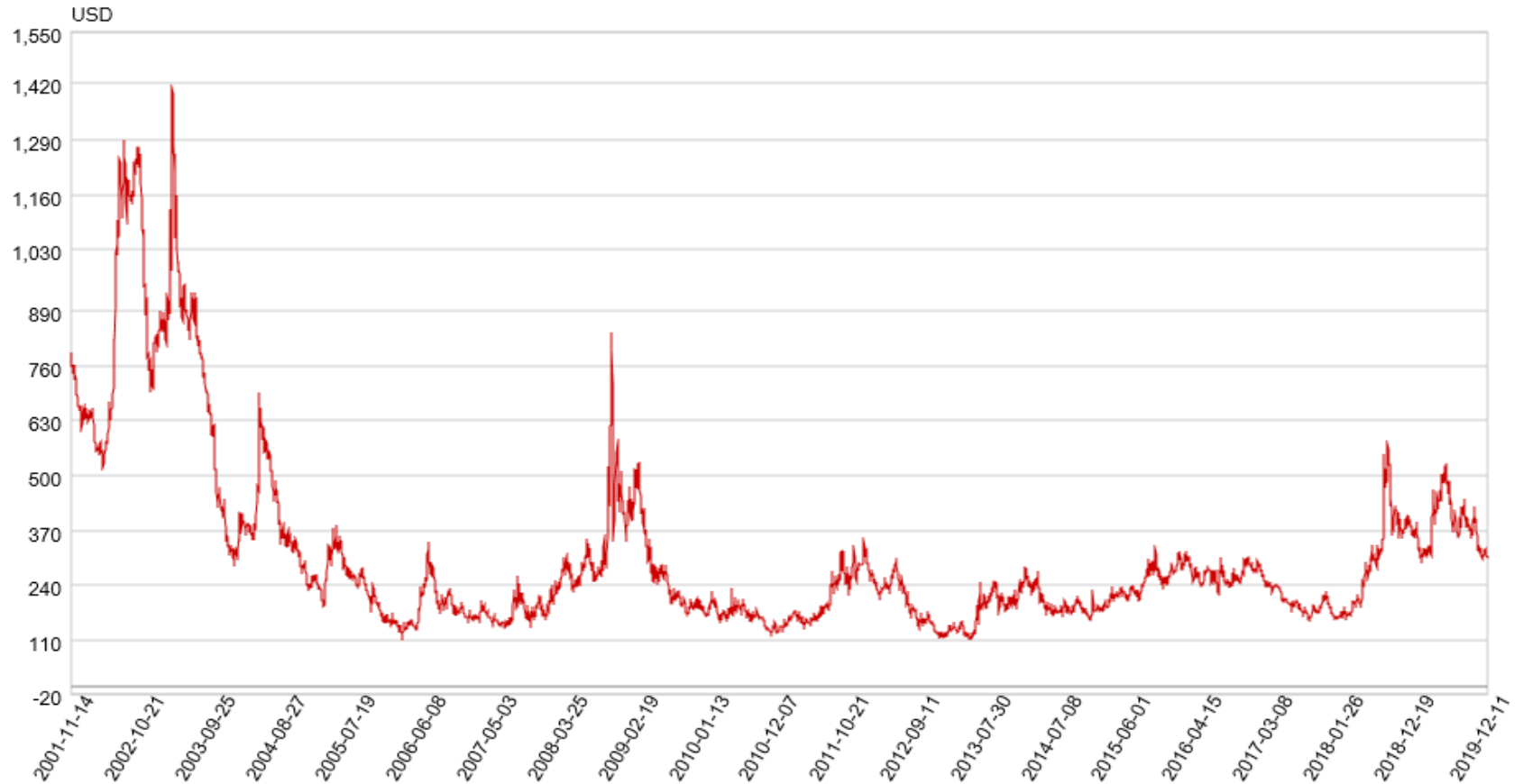


Source: Turkey Data Monitor

5 year CDS Rate

5-Year CDS Rate (Bloomberg)

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Source: Turkey Data Monitor

Turkish Economy

- GDP increased by 0.9 yoy in 3Q, broadly in line with the Bloomberg consensus forecast of +1% yoy (%-1.6 yoy in 2Q)
- Third quarter GDP confirms the stabilization in the economy. Leading indicators like credit momentum suggest that growth in the last quarter will be stronger.
- Headline CPI increased by 0,38% in November (October: +2%), better than the Bloomberg consensus forecast of +0.75%. On a yearly basis CPI increased to 10.56% in November from 8.55% yoy in October due to base effects.
- The annual core inflation rate increased to 9.25% in November from 6.67%, higher than the Bloomberg consensus forecast of 8.90%.
- PPI decreased slightly by 0.08% mom in November (October: +0.17%) and 12-month PPI inflation increased to 4.26% from 1.70%.
- As expected, headline inflation has risen due to base effects.
- On December 12, CBRT cut the policy rate (one-week repo auction rate) from 14 percent to 12 percent.

Turkish Economy

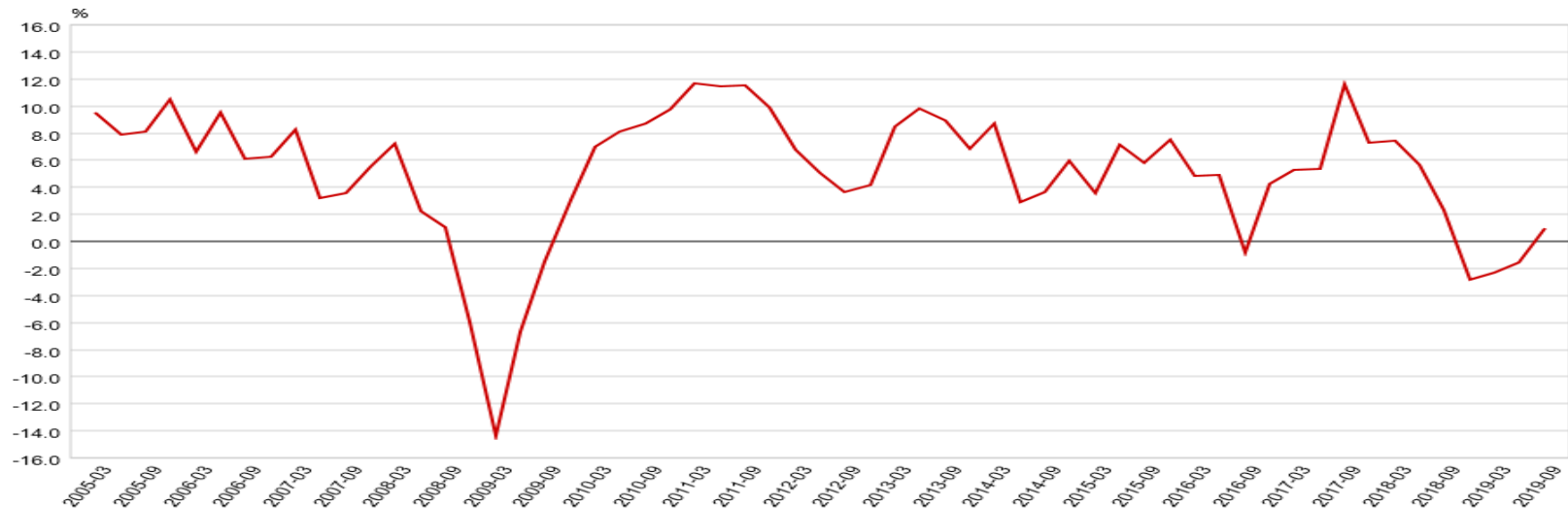
- CBRT cut the one week repo rate by 425bps at July, 325bps at September, 250bps at October and 200 bps at December meeting resulting in a total of 1,200 basis points this year.
- CBRT emphasized that inflation is likely to materialize close to the lower bound of the October Inflation Report projections for the end of the year (11.2-12.8%), with risks around the disinflation path for 2020 being balanced.
- 12-month rolling current account surplus decreased to \$4.3 bn in October from \$5.4 bn in September.
- We expect that the current account surplus will decrease and turn into a deficit as the growth rate increases in the coming months.
- In October despite the recovery in the indirect tax revenues due to SCT (Special Consumption Tax), the budget balance recorded a higher deficit than last year due to the high course of primary expenditures. While the budget recorded a deficit of TL 14.9 billion in October, on a twelve month basis the deficit increased to TL 111.2 billion.

Growth

- GDP was increased by 0.9 yoy in 3Q, broadly in line with the Bloomberg consensus forecast of +1% yoy (%-1.6 yoy in 2Q)
- Looking at the details, household spending recovered and investment spending continued to shrink at a slower pace in the third quarter of 2019 on a yearly basis. Household spending increased by 1.5% yoy in 3Q (-1% yoy in 2Q) and investment spending contracted 12.6% yoy in 3Q (-22.4 % yoy in 2Q)
- In seasonally and workday adjusted terms, real GDP increased by 0.4% (lost momentum) qoq compared to a Boomerang consensus of +1.1% (+1% 2Q19 qoq) driven by household spending and exports.

GDP Growth (yoy, %)

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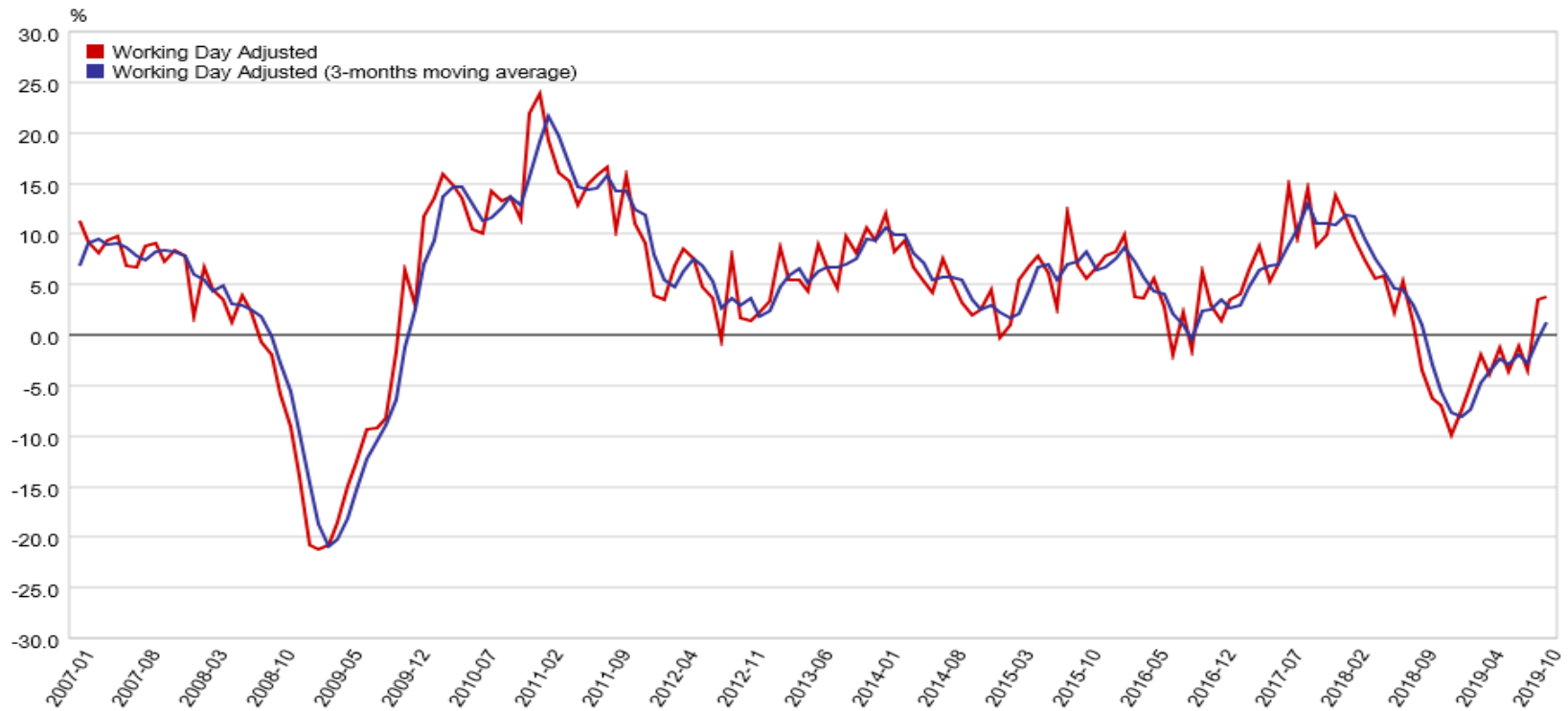
Source : Turkey Data Monitor

Industrial production recovers

- Industrial output increased by 3.8% yoy in October compared to the Bloomberg consensus of +6% yoy.
- The seasonally and workday adjusted industrial output was decreased by %0.9 mom in October (September: +3.4%)

Industrial Production: Working Day Adjusted (yoy, %)

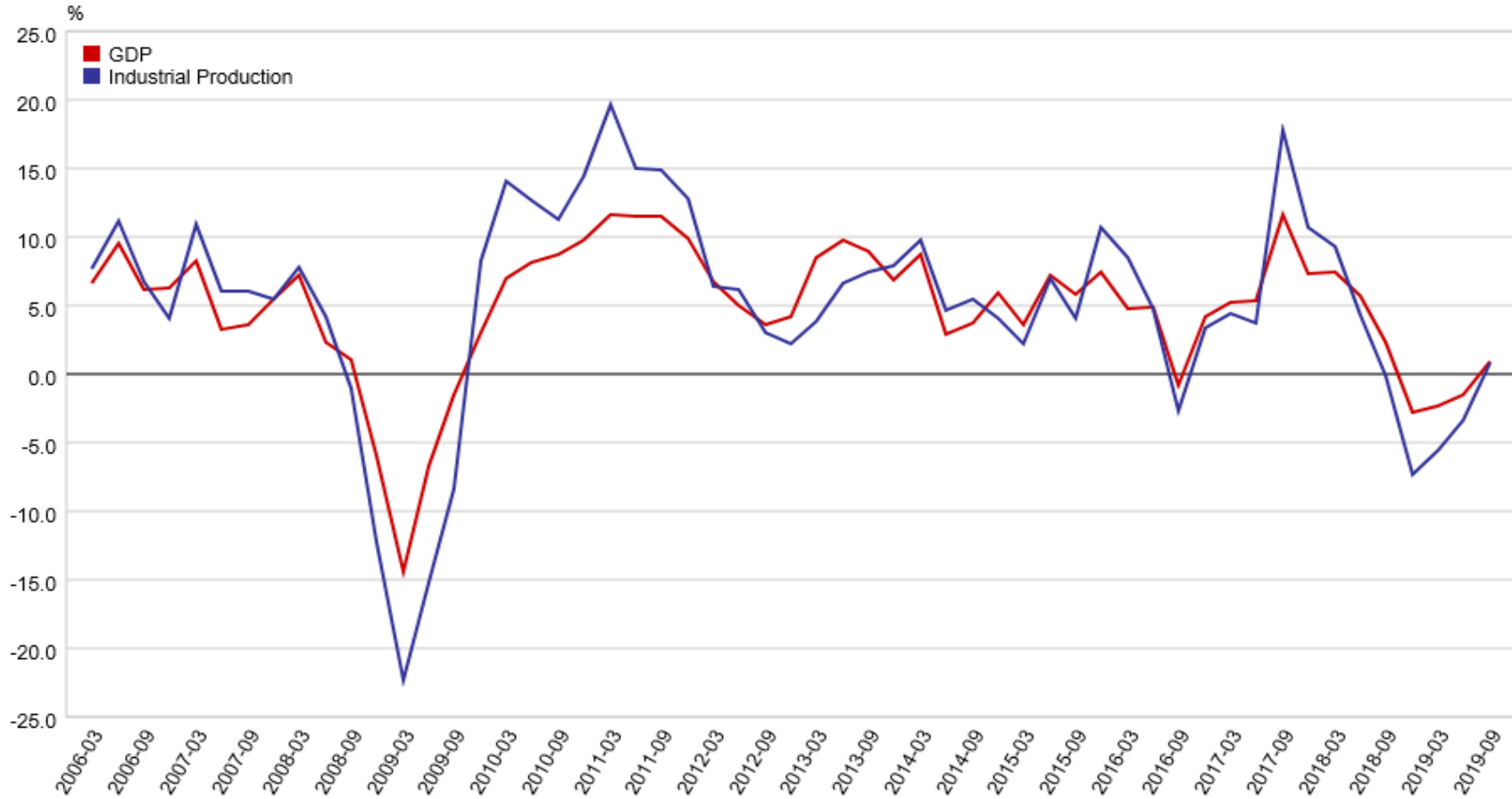
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Source : Turkey Data Monitor

GDP & Industrial Production

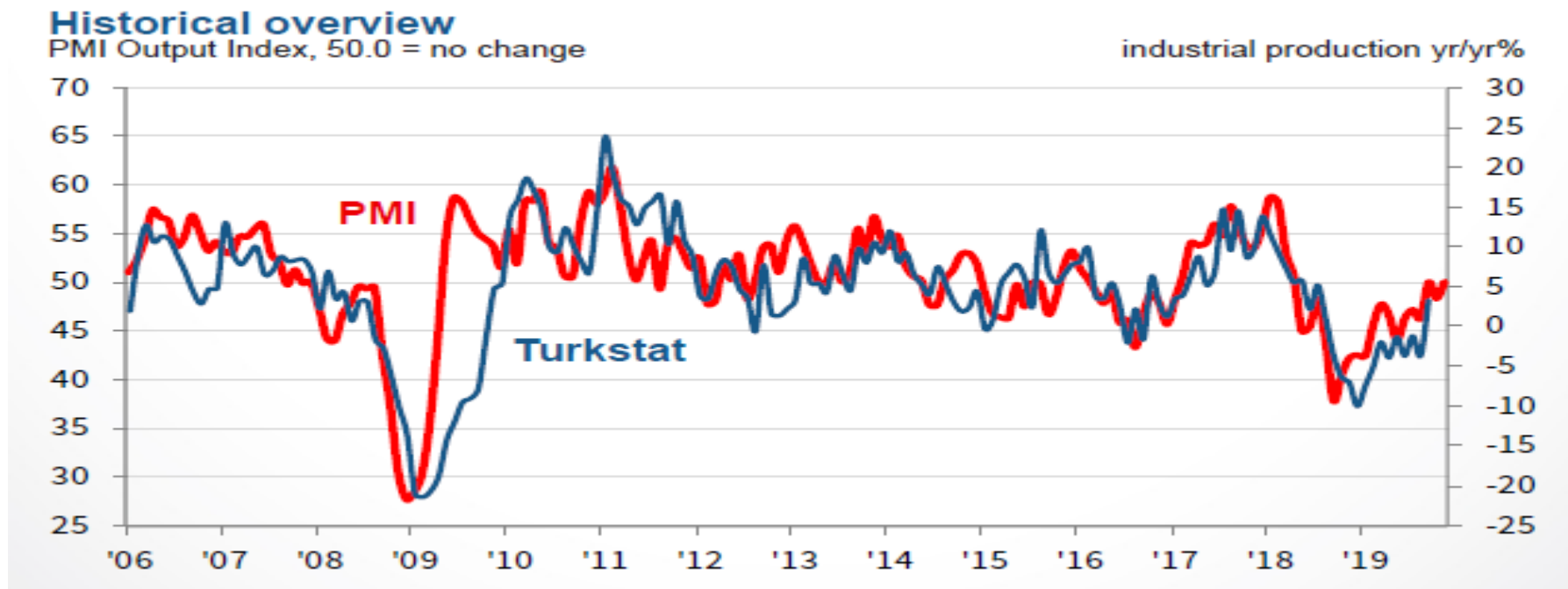
GDP and Industrial Production (yoy, %)



Source : Turkey Data Monitor

PMI manufacturing index

- The headline PMI rose to 49.5 in November from 49.0 in October.
- Manufacturing production increased fractionally in November, the first rise since April 2018. New orders continued to soften as client demand remained fragile.
- The rate of input cost inflation slowed to a 58-month low midway through the final quarter of the year, with some reports of lower raw material costs.



Source: Istanbul Chamber of Industry Turkey PMI® Manufacturing Index

Loan growth

Loan Growth: Private and Public Banks (FX adjusted, 13-week moving average, annualized)



Source : Turkey Data Monitor

Loan growth

Loan Growth: Commercial and Consumer Loans (FX adjusted, 13-week moving average, annualized, %)

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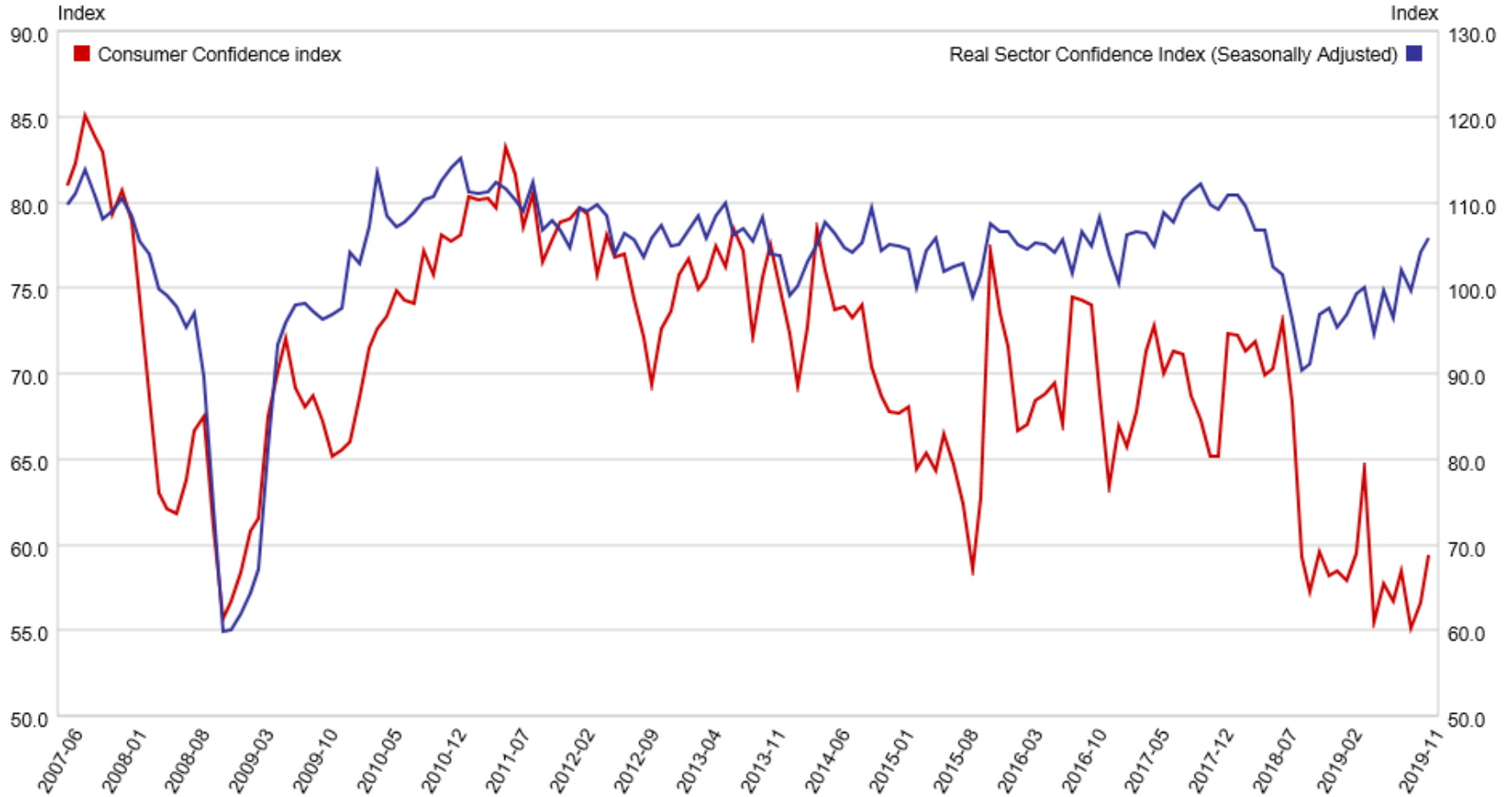


Source : Turkey Data Monitor

Confidence Indices

Consumer Confidence and Real Sector Confidence

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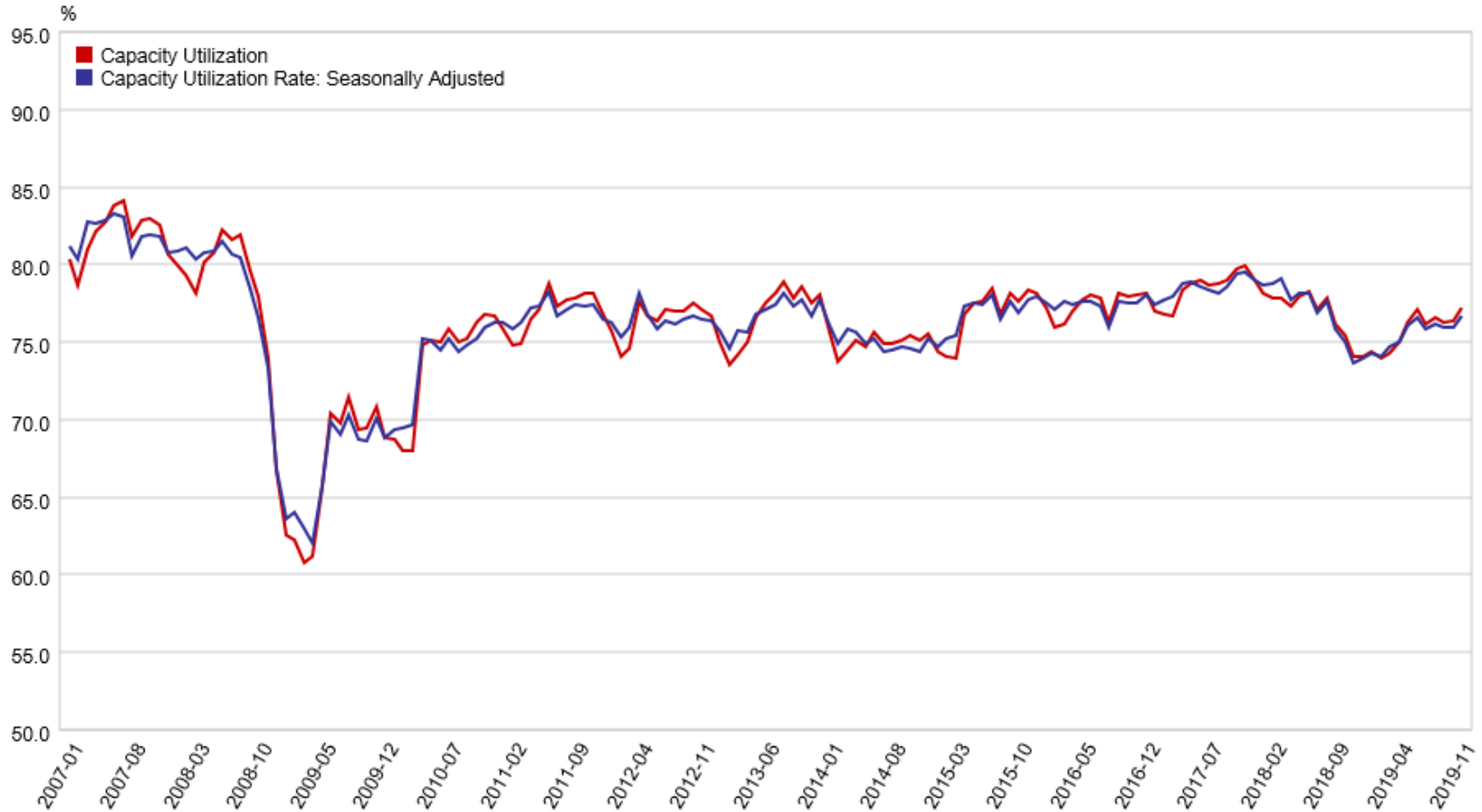


Source : Turkey Data Monitor

Capacity Utilization (%)

Capacity Utilization (%)

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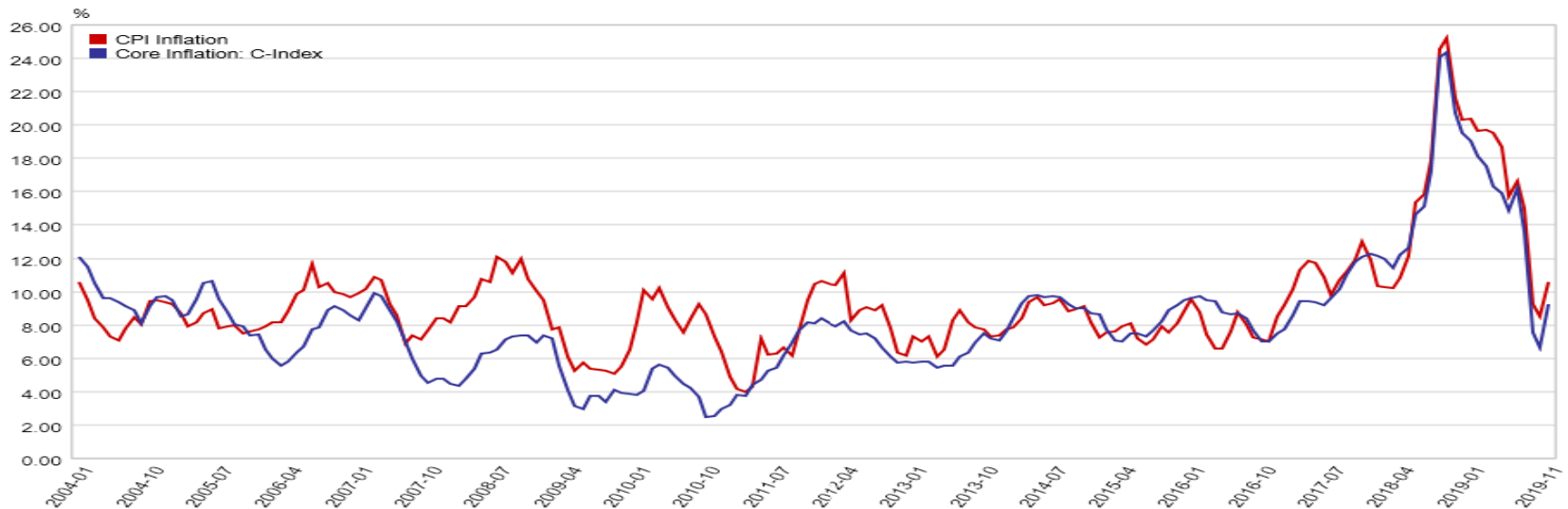
Source : Turkey Data Monitor

CPI

- Headline CPI increased by 0,38% in November (October: +2%), better than the Bloomberg consensus forecast of +0.75%.
- On a yearly basis CPI increased to 10.56% in November from 8.55% yoy in October, compared to the Bloomberg consensus forecast of 11%, due to base effects.
- The highest monthly increase was 2.69% in clothing and footwear followed by furnishing and household equipment (0.59%), communication (0.39%), housing (0.36%) and transportation (0.33%) The highest monthly decrease was 0.44% in miscellaneous goods and services followed by hotels, cafes and restaurants (0.15%).

CPI and Core Inflation (yoy, %)

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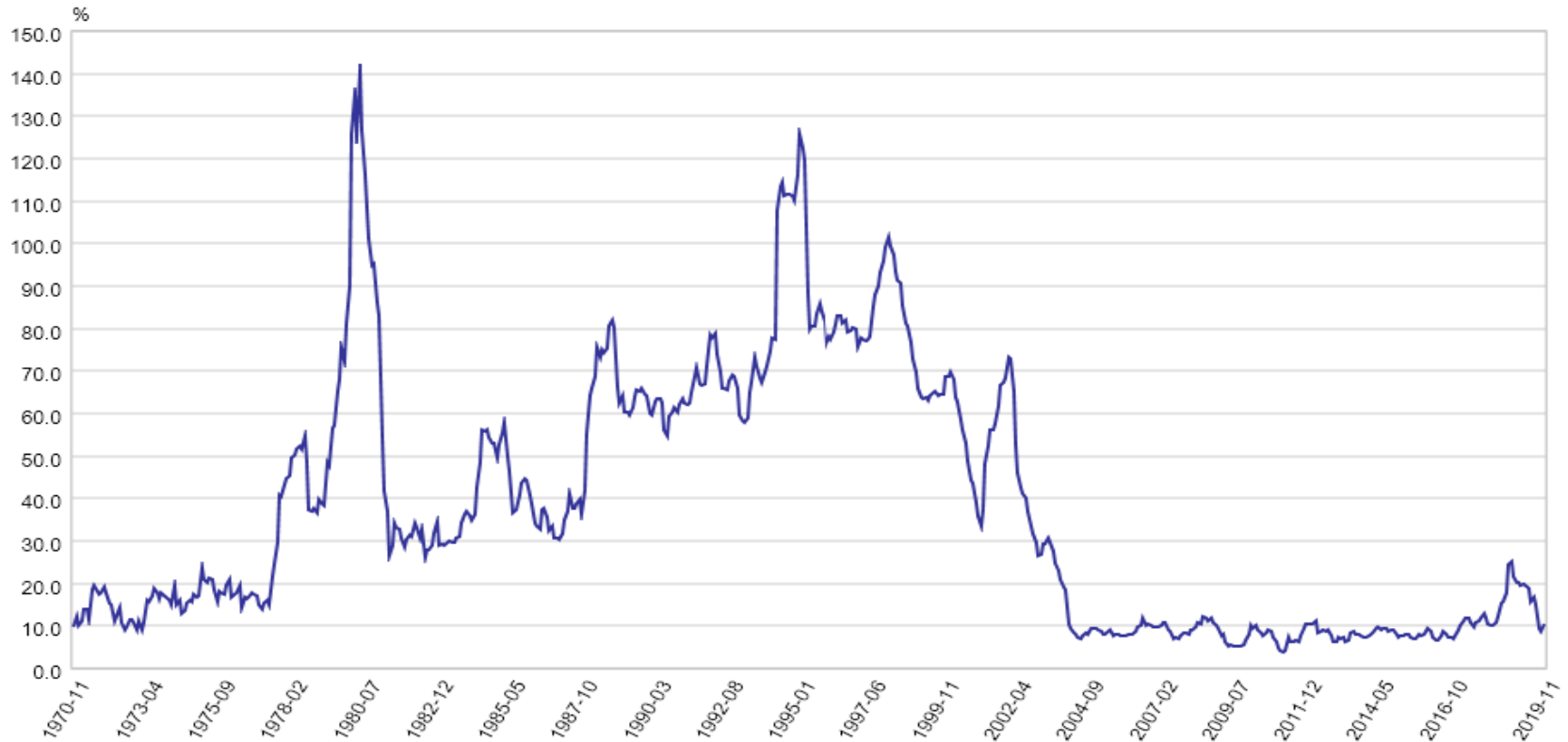
Source : Turkey Data Monitor

Long View: CPI

- In November the highest annual increase was 43.35% in alcoholic beverages and tobacco. Education with 14.35%, miscellaneous goods and services with 14.03%, health with 13.85% and hotels, cafes and restaurants with 13.07% were the other main groups where high annual increases realized.

Long View: CPI Inflation (yoy, %)

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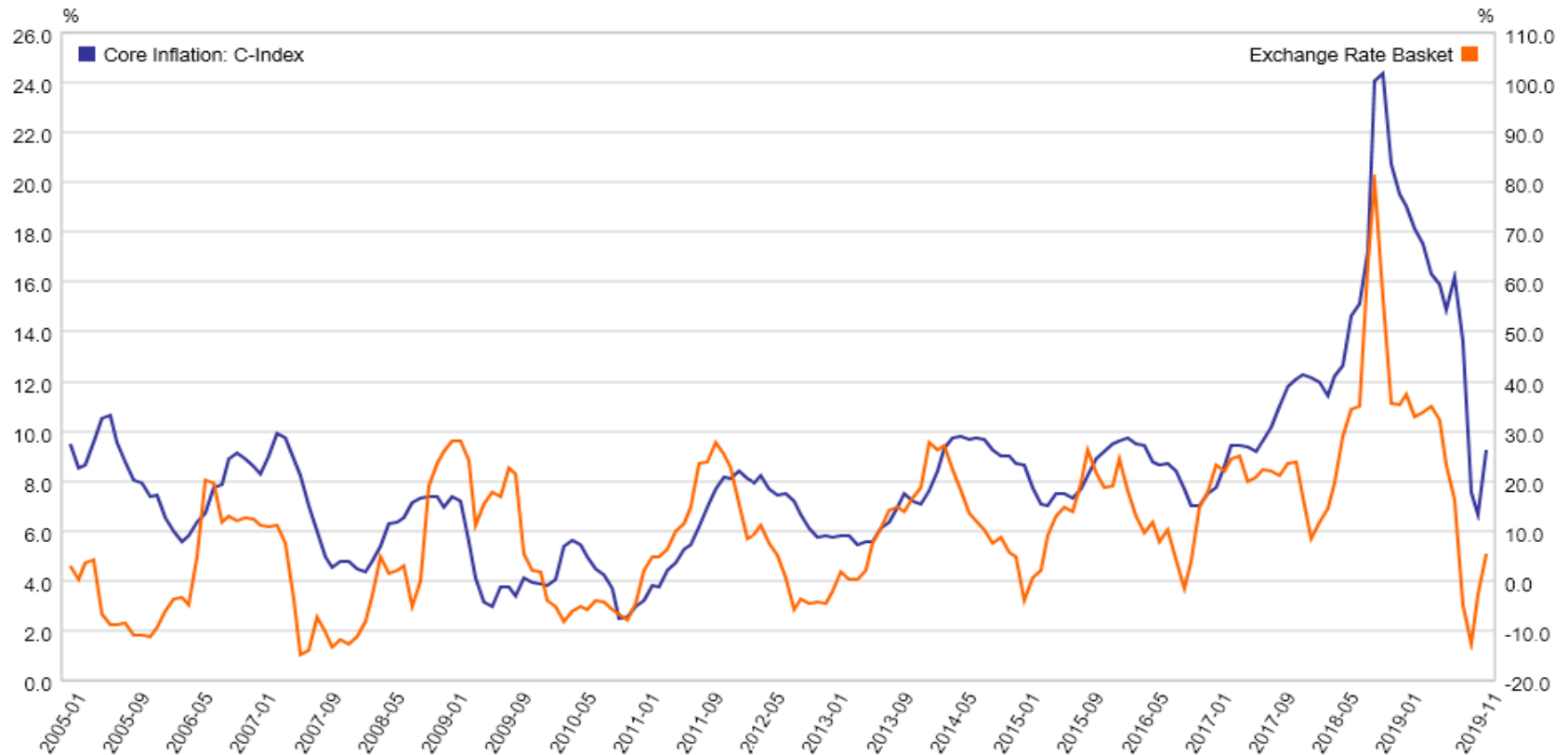
Source: Turkey Data Monitor

Core inflation

- Core CPI increased by 0.51% in November mom (+1.78% in October). The annual core inflation rate increased to 9.25% in November from 6.67%, higher than the Bloomberg consensus forecast of 8.90%.

Core Inflation and Exchange Rate (yoy, %)

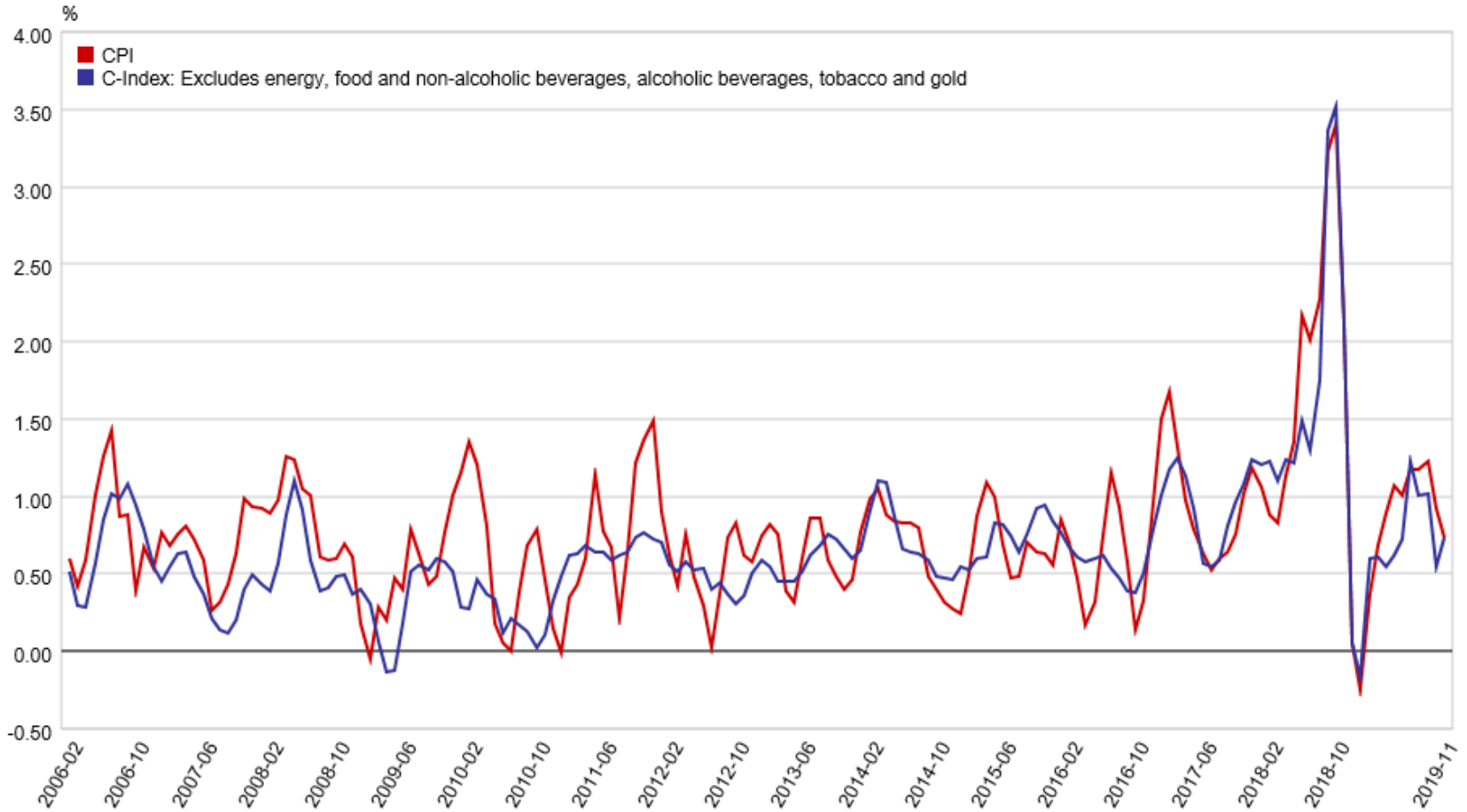
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Source : Turkey Data Monitor

Core inflation

Inflation (seasonally adjusted, mom, %)
(3-months moving average)



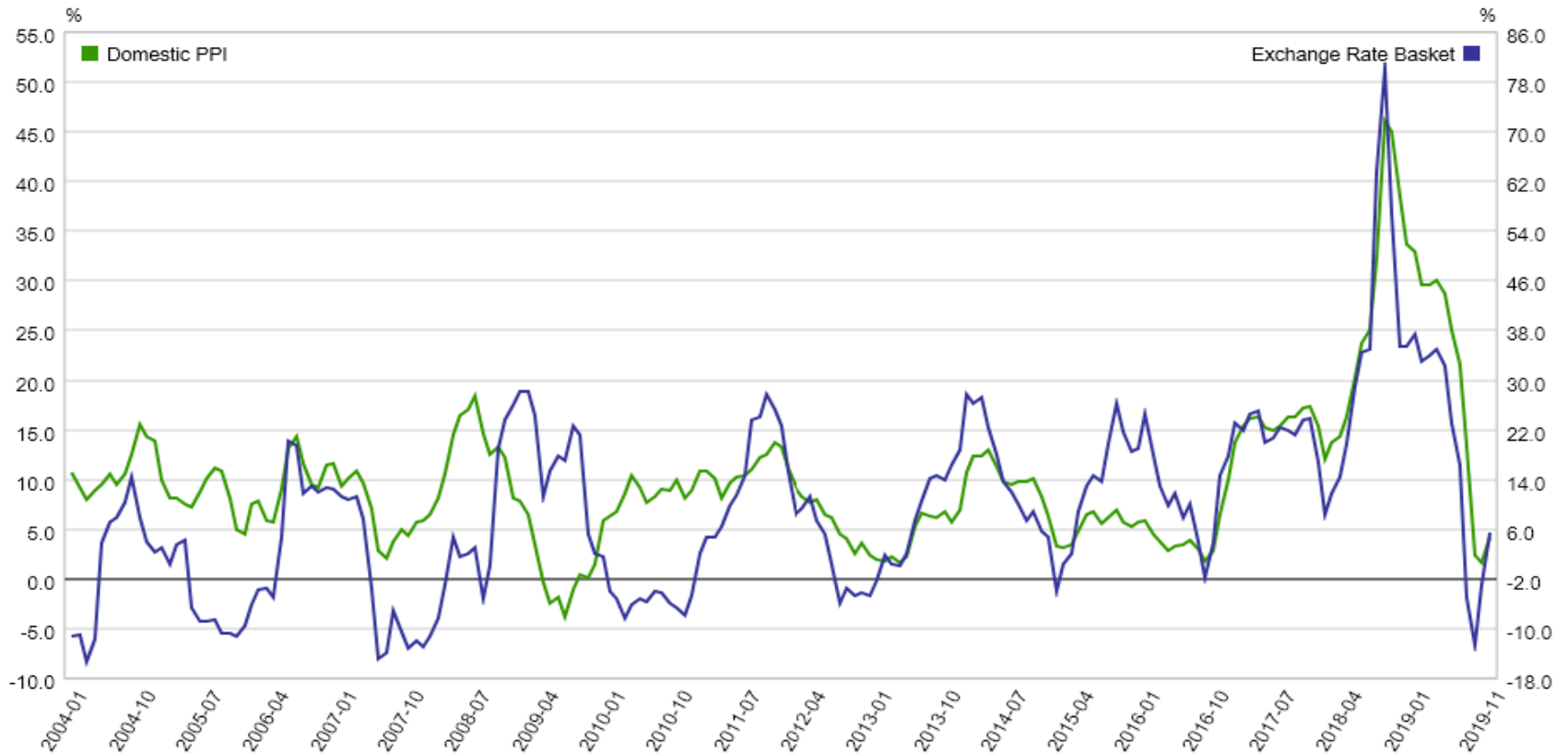
Source : Turkey Data Monitor

D-PPI Inflation

- PPI decreased slightly by 0.08% mom in November (October: +0.17%) and 12-month PPI inflation increased to 4.26% from 1.70%.

D-PPI Inflation and Exchange Rate (yoy, %)

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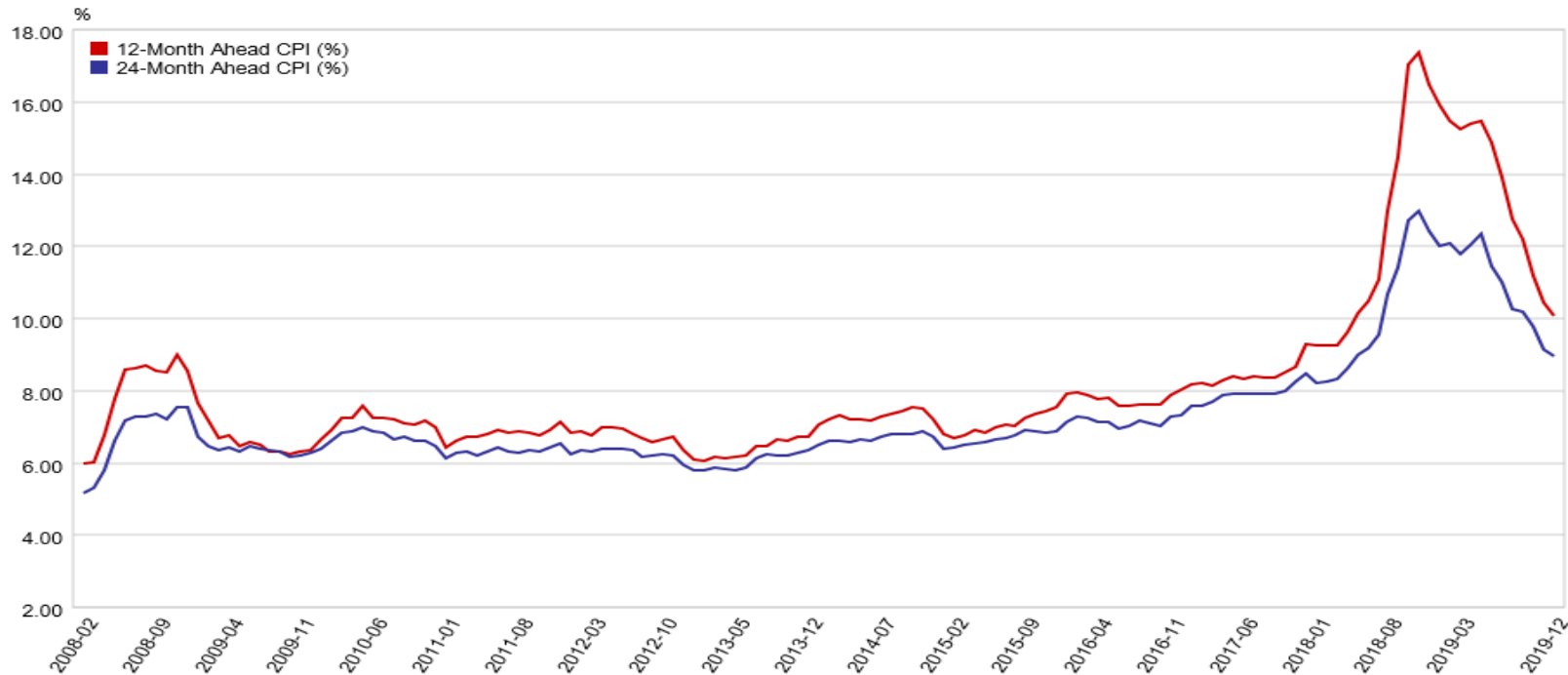
Source : Turkey Data Monitor

Inflation expectations

- According to Central Bank Expectations Survey for December, average 2019 year end inflation expectation decreased to 11,62% from 12.18 % in November.
- 12-month ahead CPI inflation expectations decreased by 39 basis points to 10.07% and 24-month ahead CPI inflation expectation decreased to 8.94% (prior: 9.16%)

Inflation Expectations (%)

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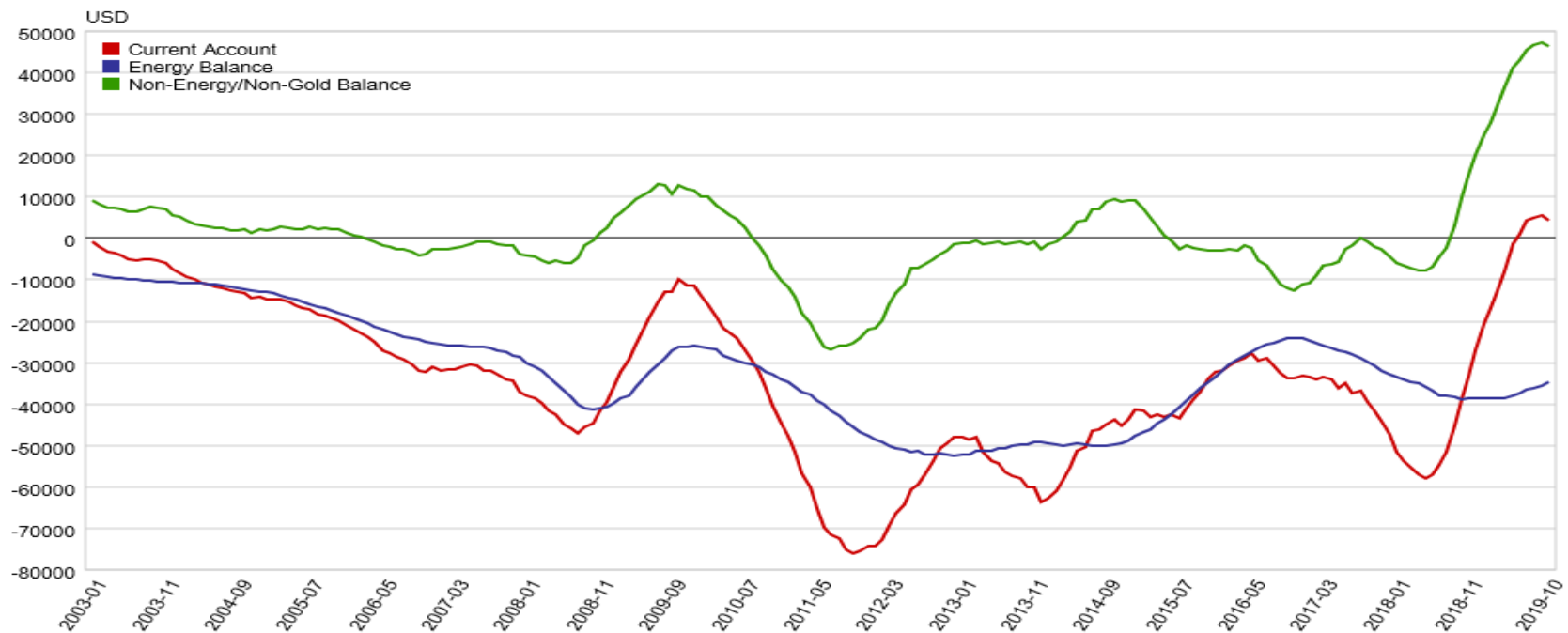
Source : Turkey Data Monitor

Current account surplus narrows

- Current account recorded a \$1.5bn surplus in October, in line with the Bloomberg consensus forecast.
- 12-month rolling current account surplus decreased to \$4.3 bn in October from \$5.4 bn in September.
- We expect that the current account surplus will decrease and turn into a deficit as the growth rate increases in the coming months.

Current Account Balance (12-m rolling, million USD)

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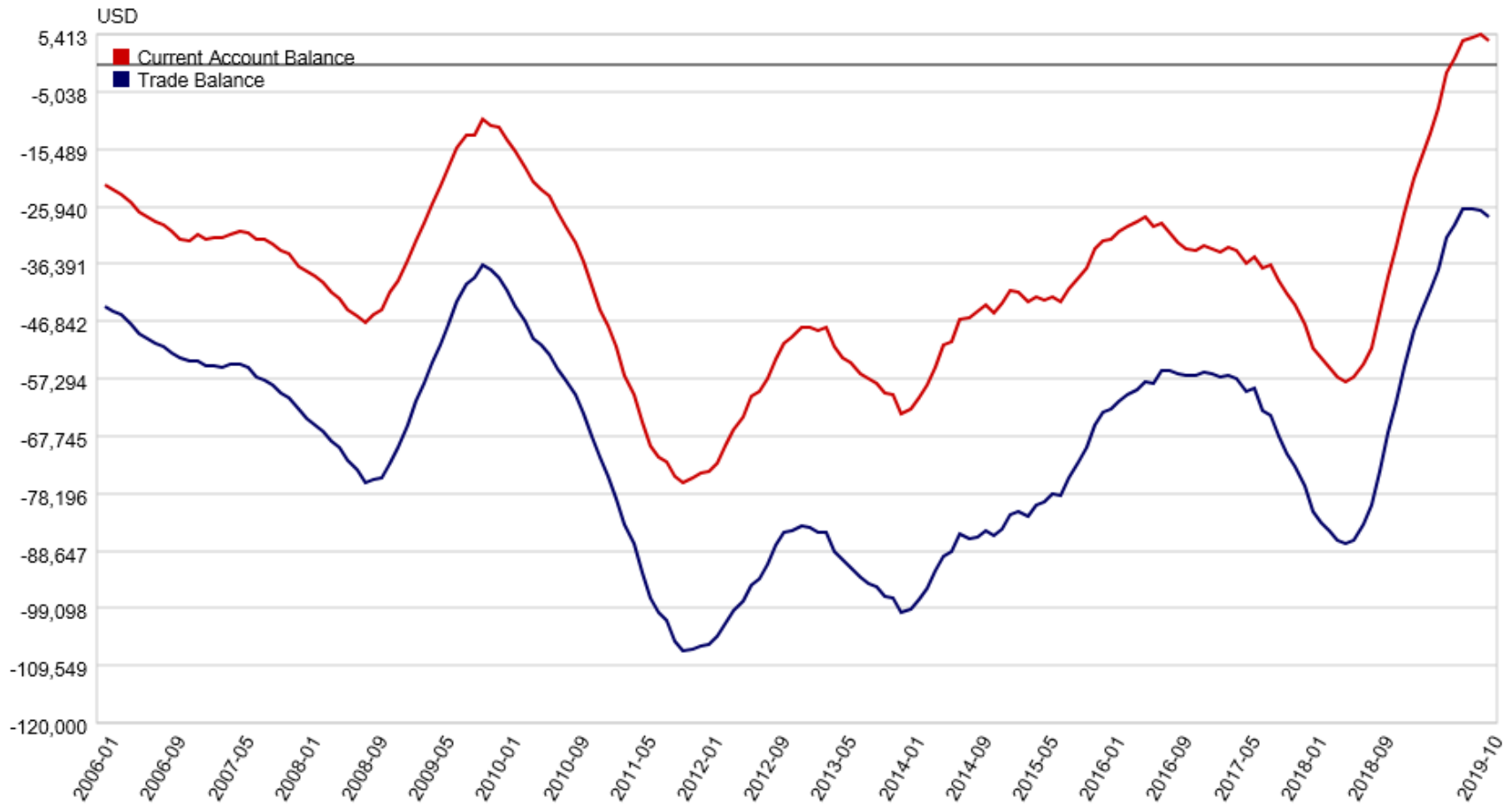


Source : Turkey Data Monitor

Current account and trade balance

Current Account and Trade Balance (12-m rolling, million USD)

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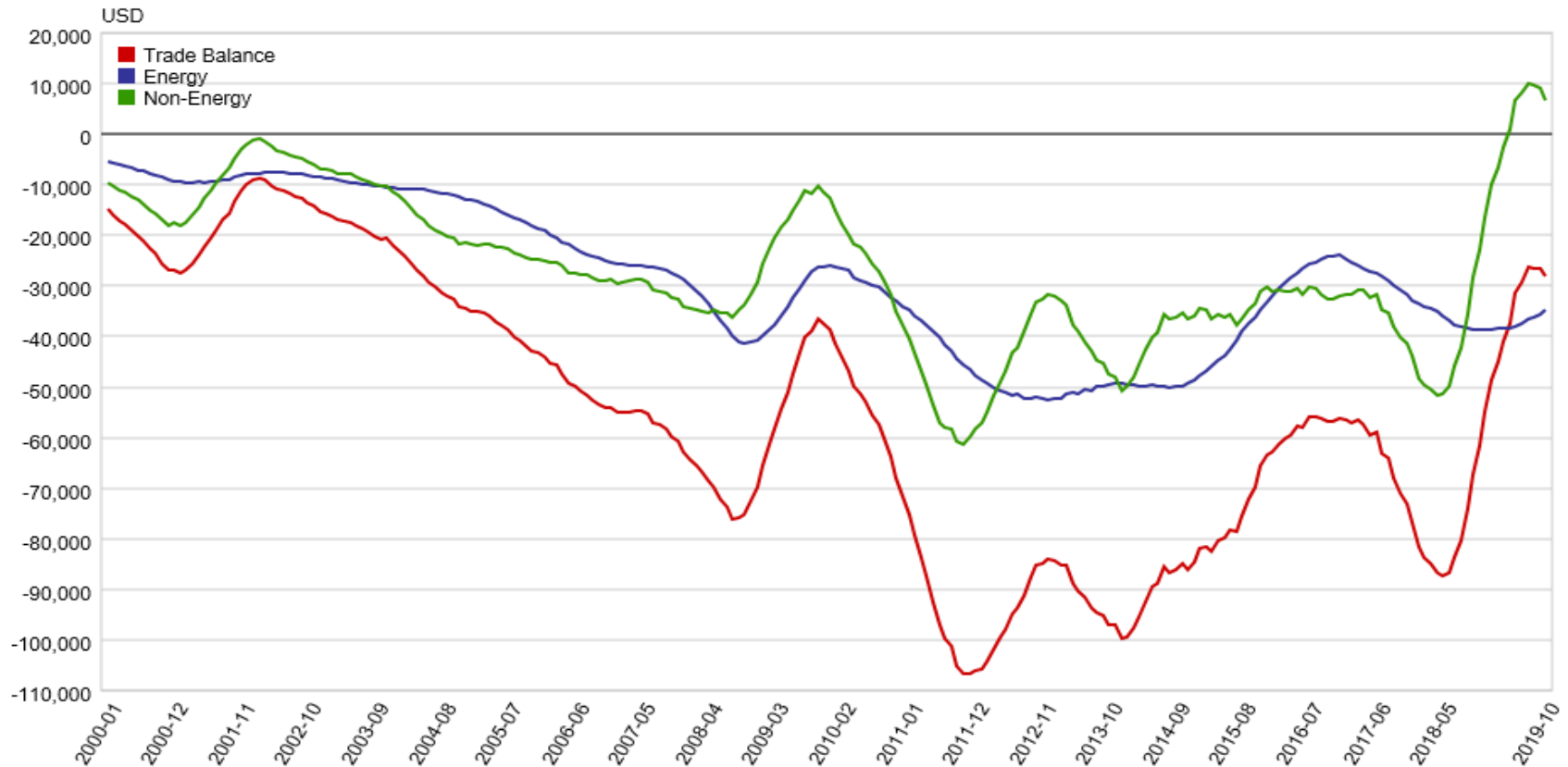
Source : Turkey Data Monitor

Foreign Trade

- The deficit was \$ 1.8 billion in October and the total 12-month deficit increased to 28\$ billion from 26.6 \$ billion. In October imports increased by 8% year-on-year.

Trade Balance: Energy/Non-Energy (million USD, 12-m rolling)

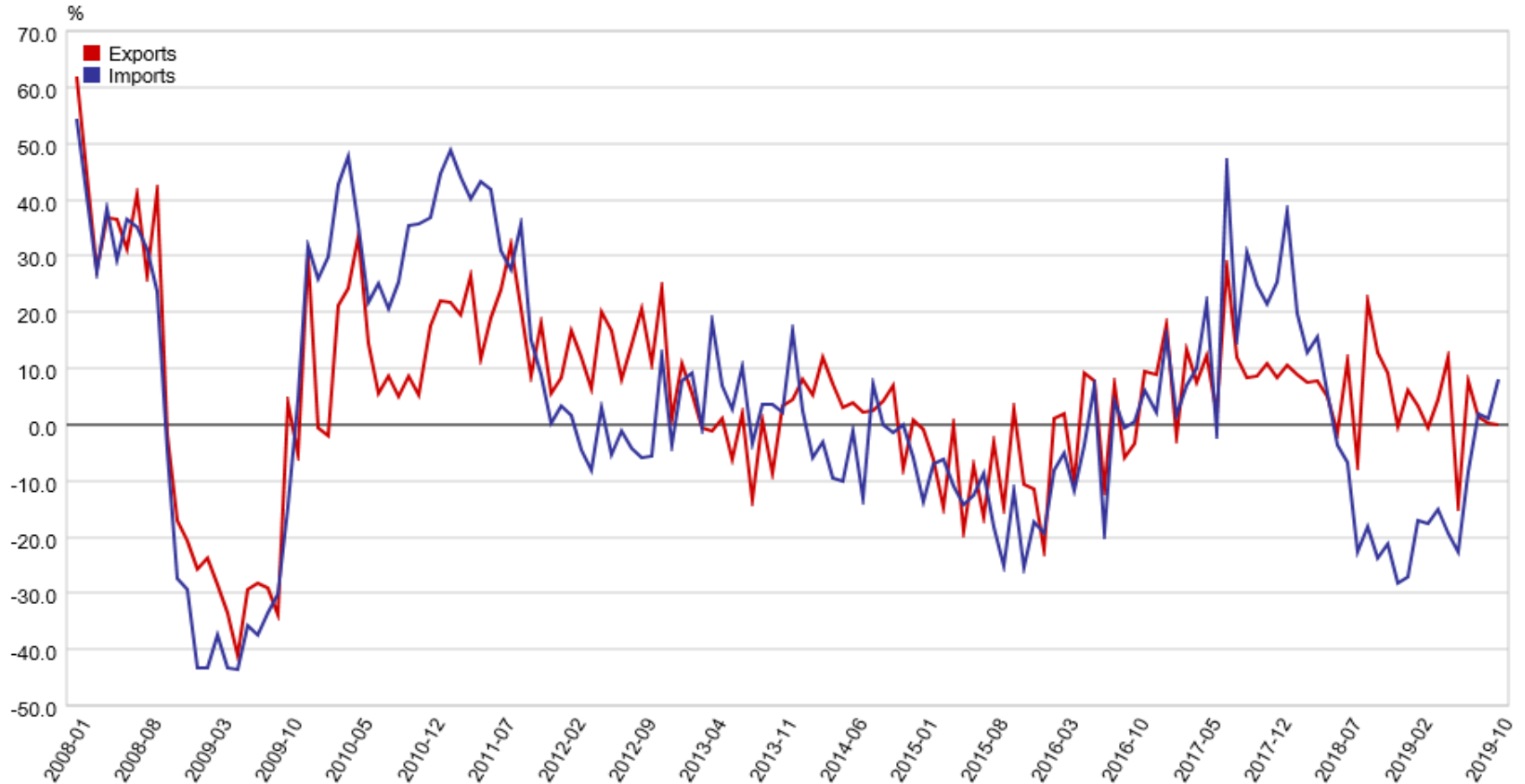
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Source : Turkey Data Monitor

Export and Import Growth

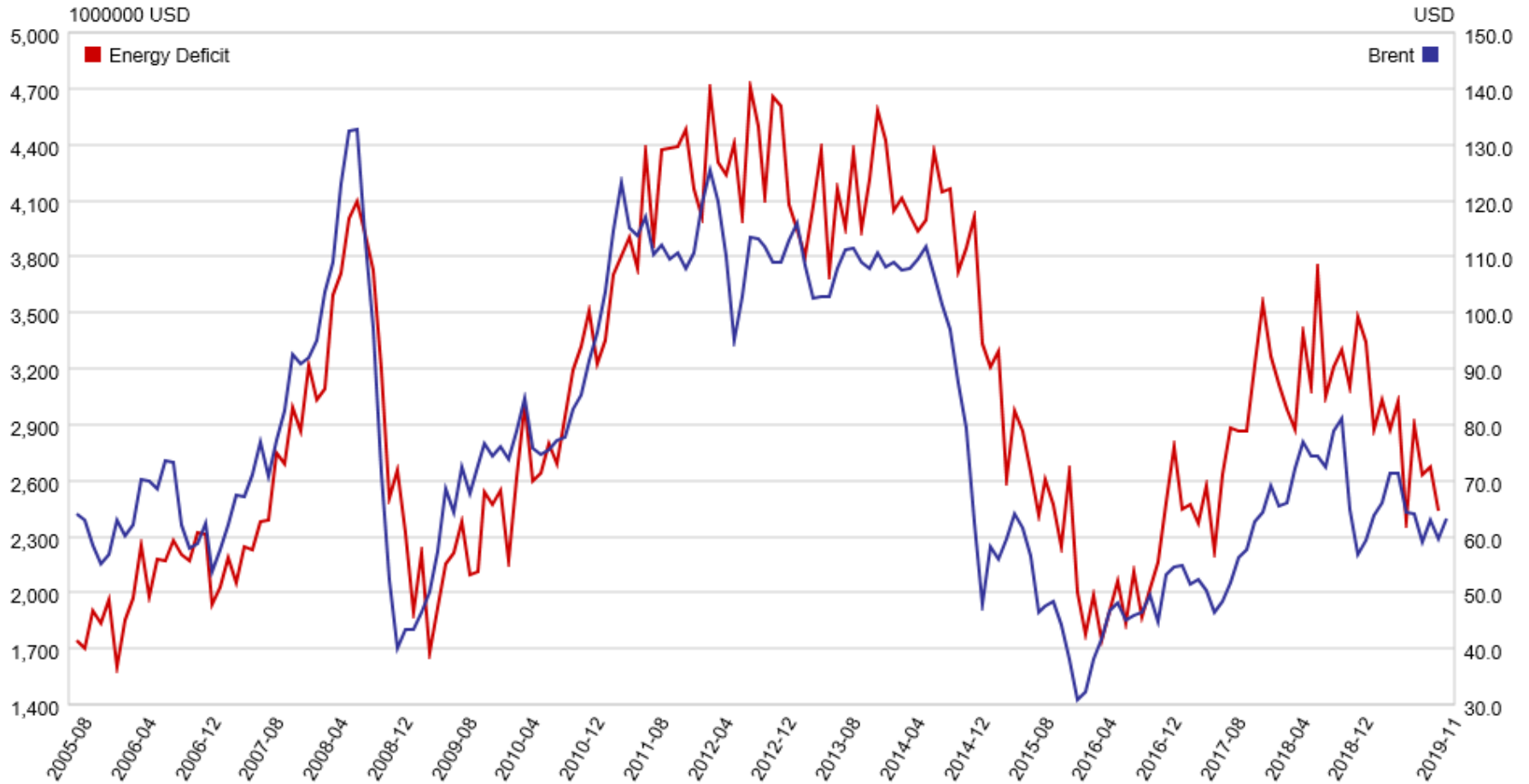
Export and Import Growth (yoy, %)



Source : Turkey Data Monitor

Energy deficit & Oil Prices

Energy Trade Deficit and Oil Prices



Source : Turkey Data Monitor

CBRT cut the policy rate

- CBRT cut the one week repo rate by 425bps at July, 325bps at September, 250bps at October and 200 bps at December meeting resulting in a total of 1,200 basis points this year.
- CBRT emphasized that inflation is likely to materialize close to the lower bound of the October Inflation Report projections for the end of the year (11.2-12.8%), with risks around the disinflation path for 2020 being balanced.

CBRT Funding Rate

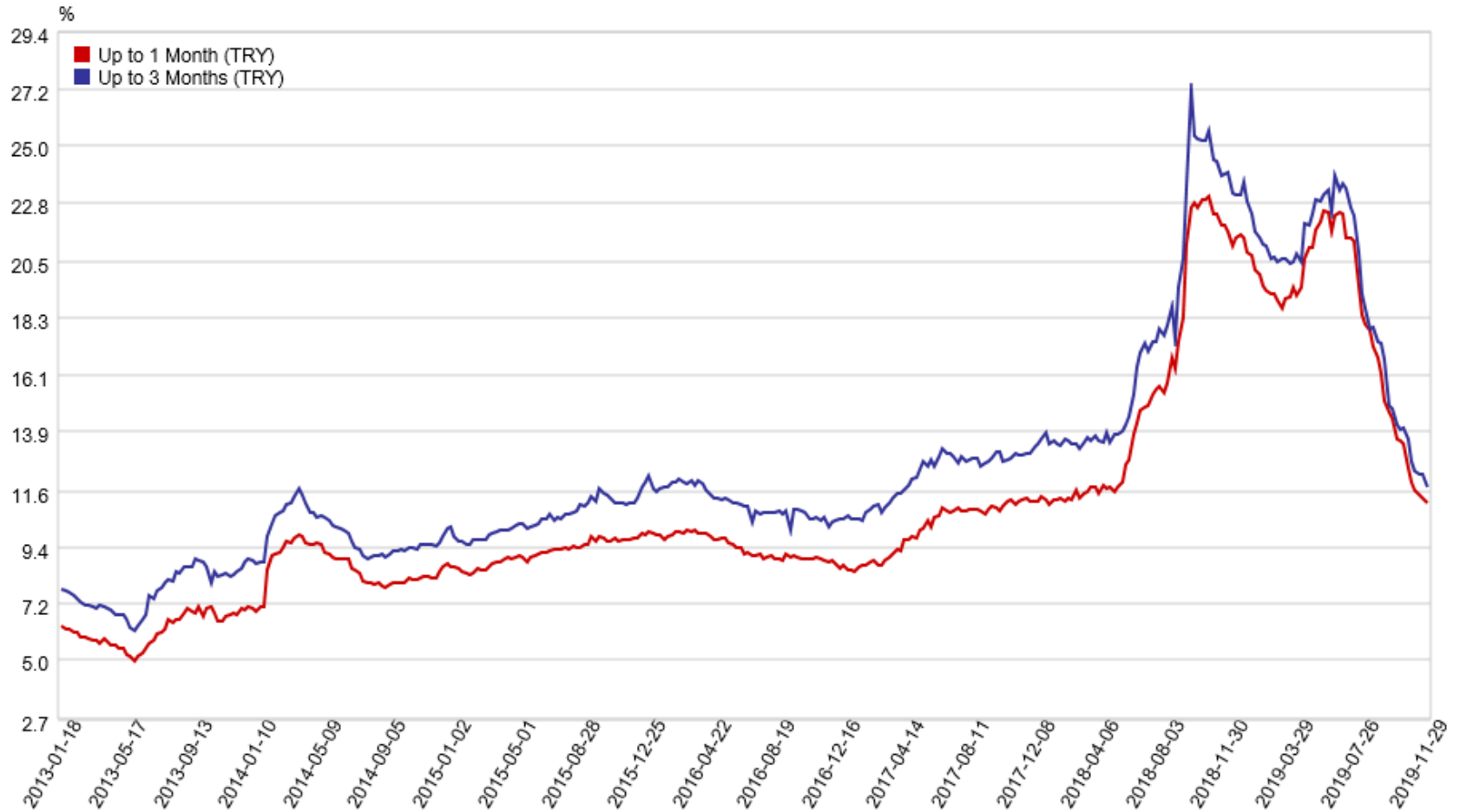
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Source: Turkey Data Monitor

Deposit Rates

Deposit Rates

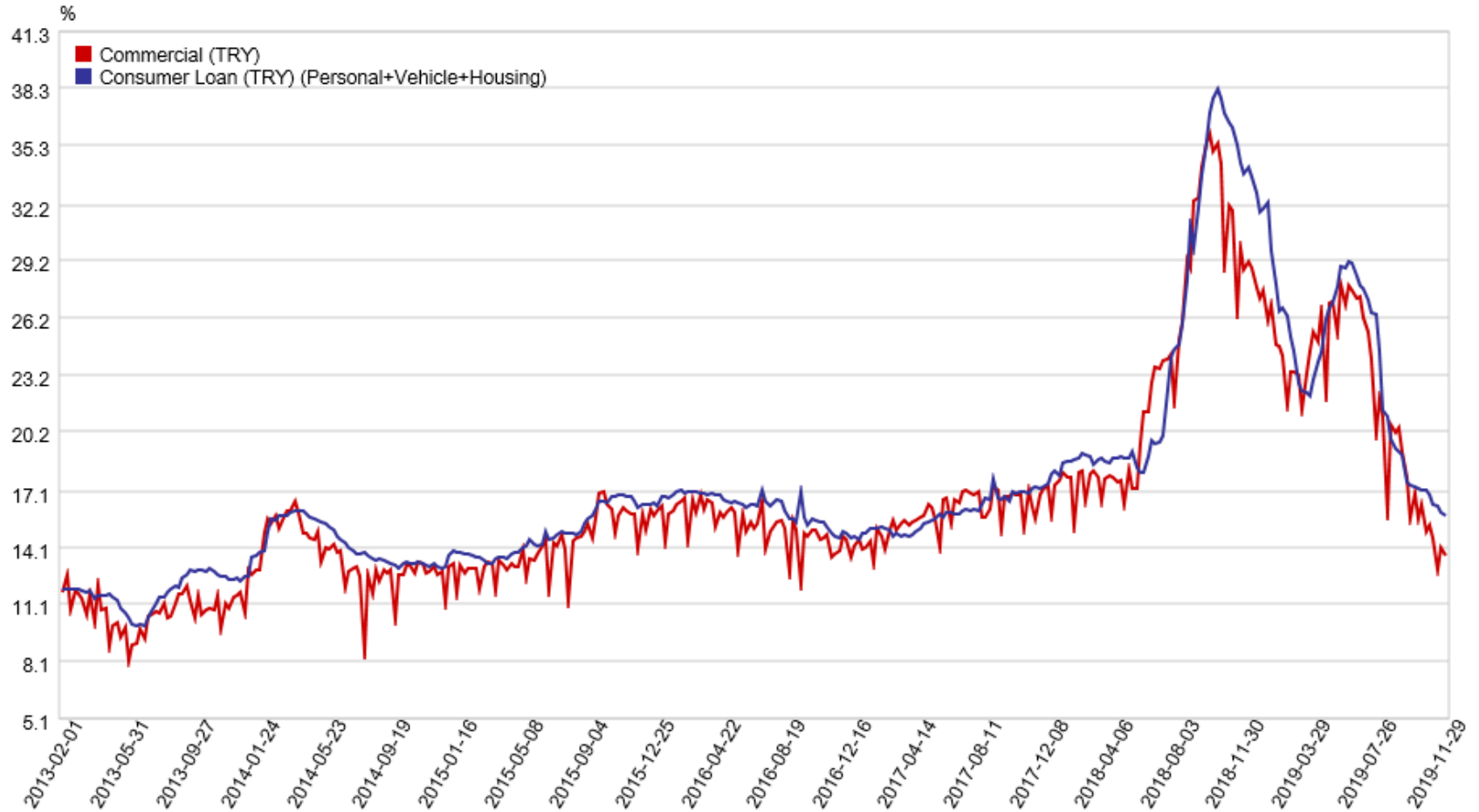


Source: Turkey Data Monitor

Lending rates

Lending Rates

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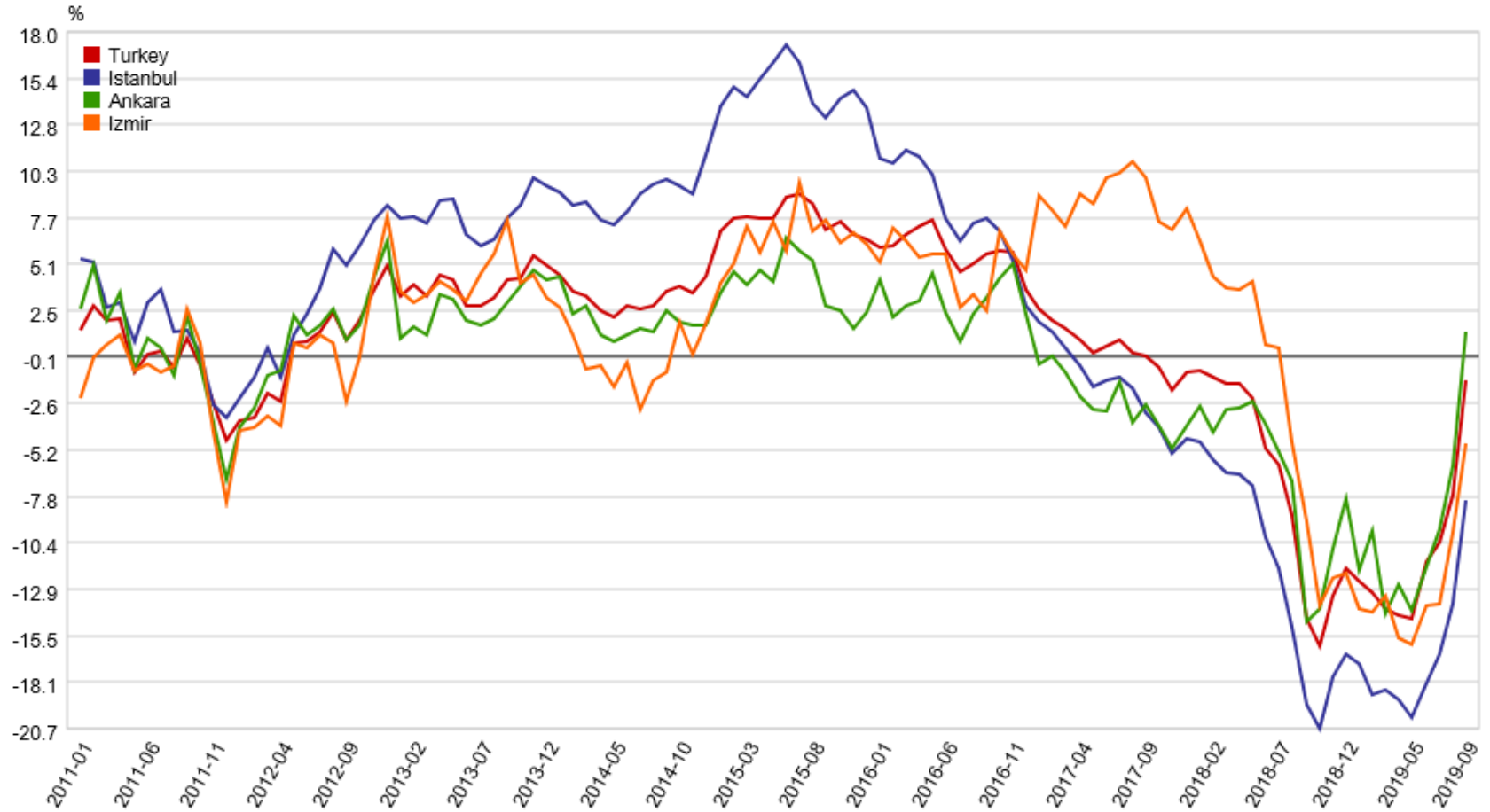


Source: Turkey Data Monitor

House prices

CBRT House Price Index: New Homes

(real, 12-month, %)

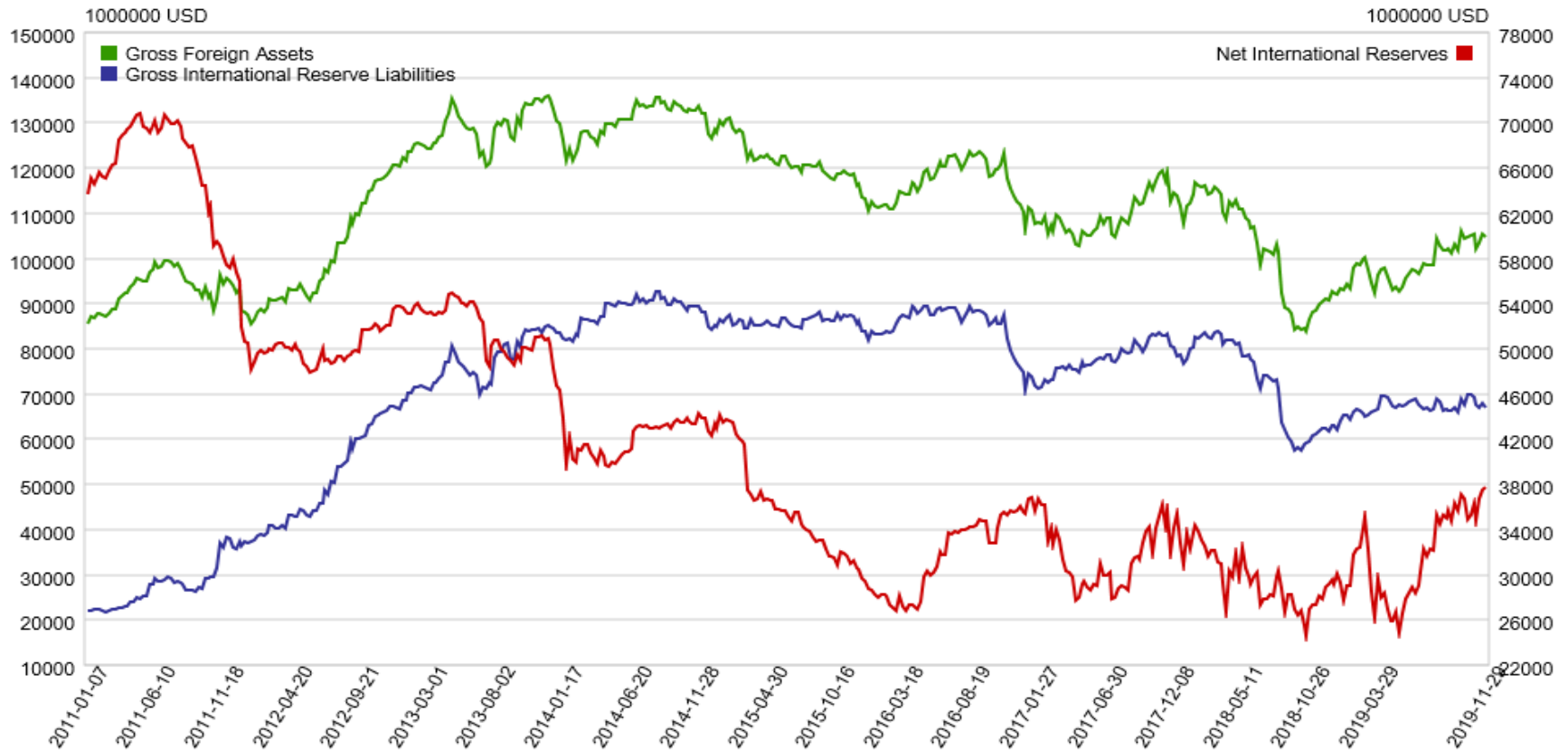


Source: Turkey Data Monitor

CBRT Net International Reserves

- CBRT's net reserves stand at \$36.2 billion as of November 1, compared to \$30 billion at the beginning of 2019.

CBRT Net International Reserves (million USD)

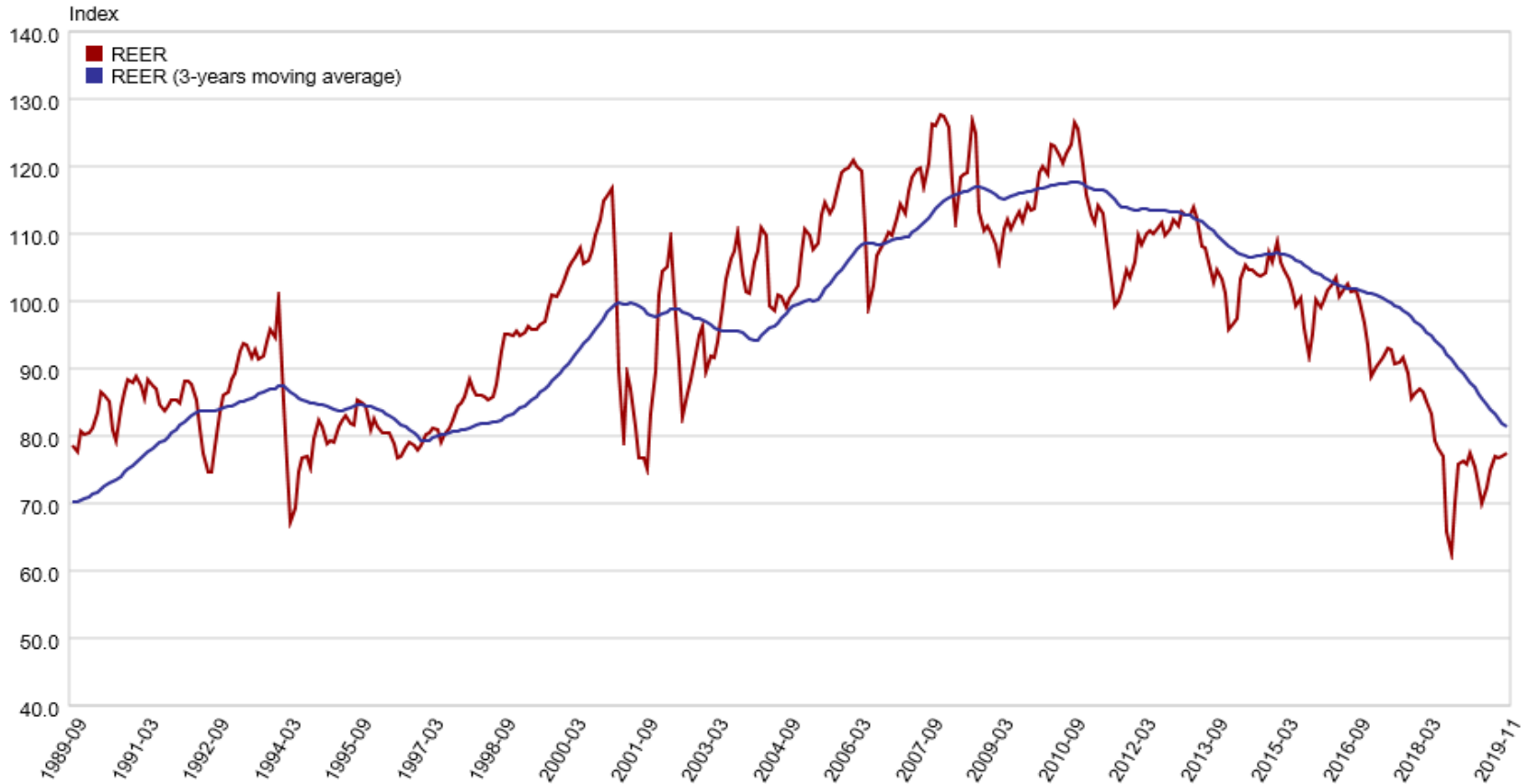


Source: Turkey Data Monitor

TL: Real effective exchange rate

- CBRT's real effective exchange rate increased to 77.4 in November (76.9 in October)

Long View: Real Effective Exchange Rate (2003=100)

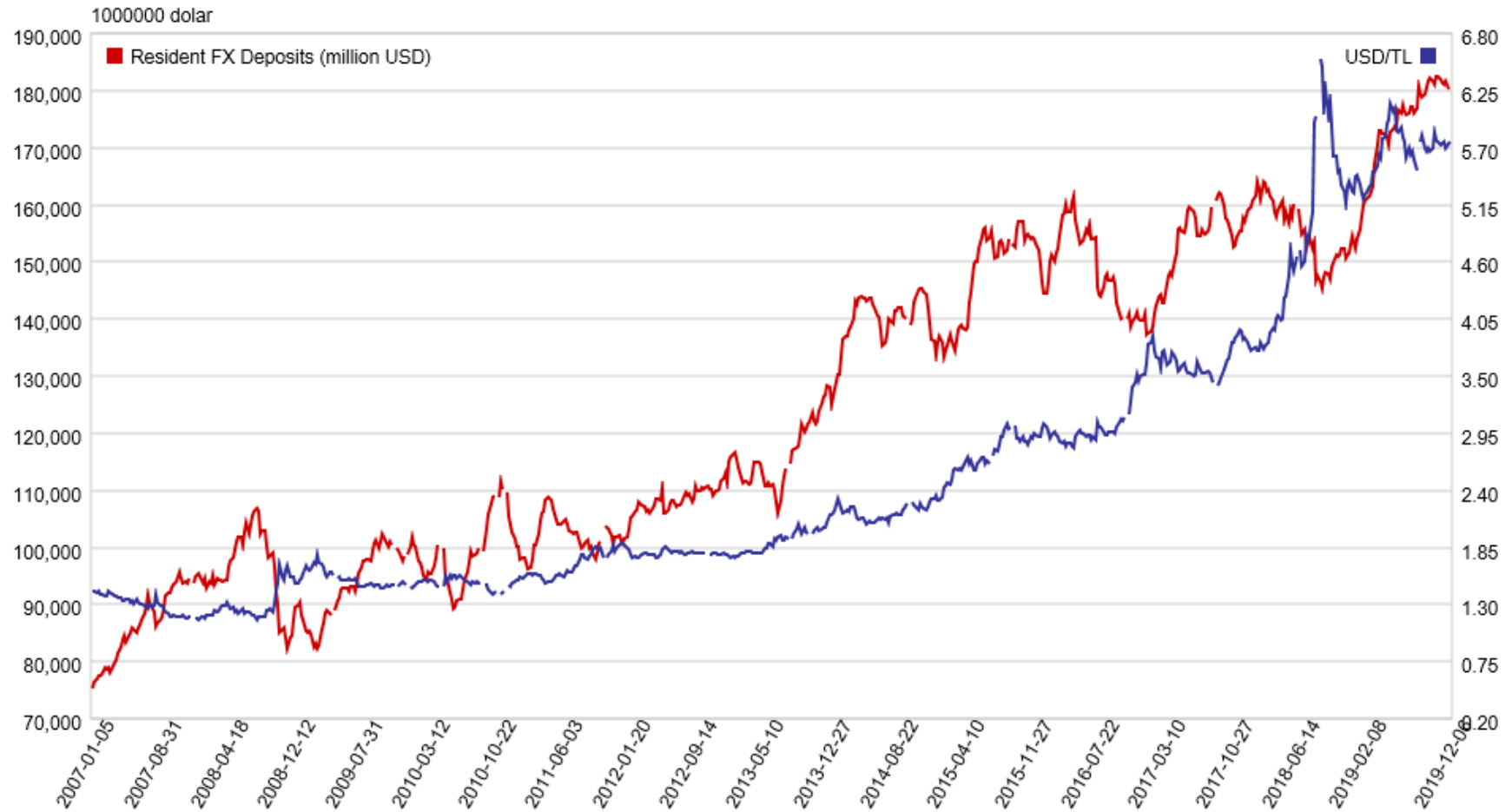


Source: Turkey Data Monitor

FX deposits of residents & USD/TL

FX Deposits of Residents and USD/TL Rate

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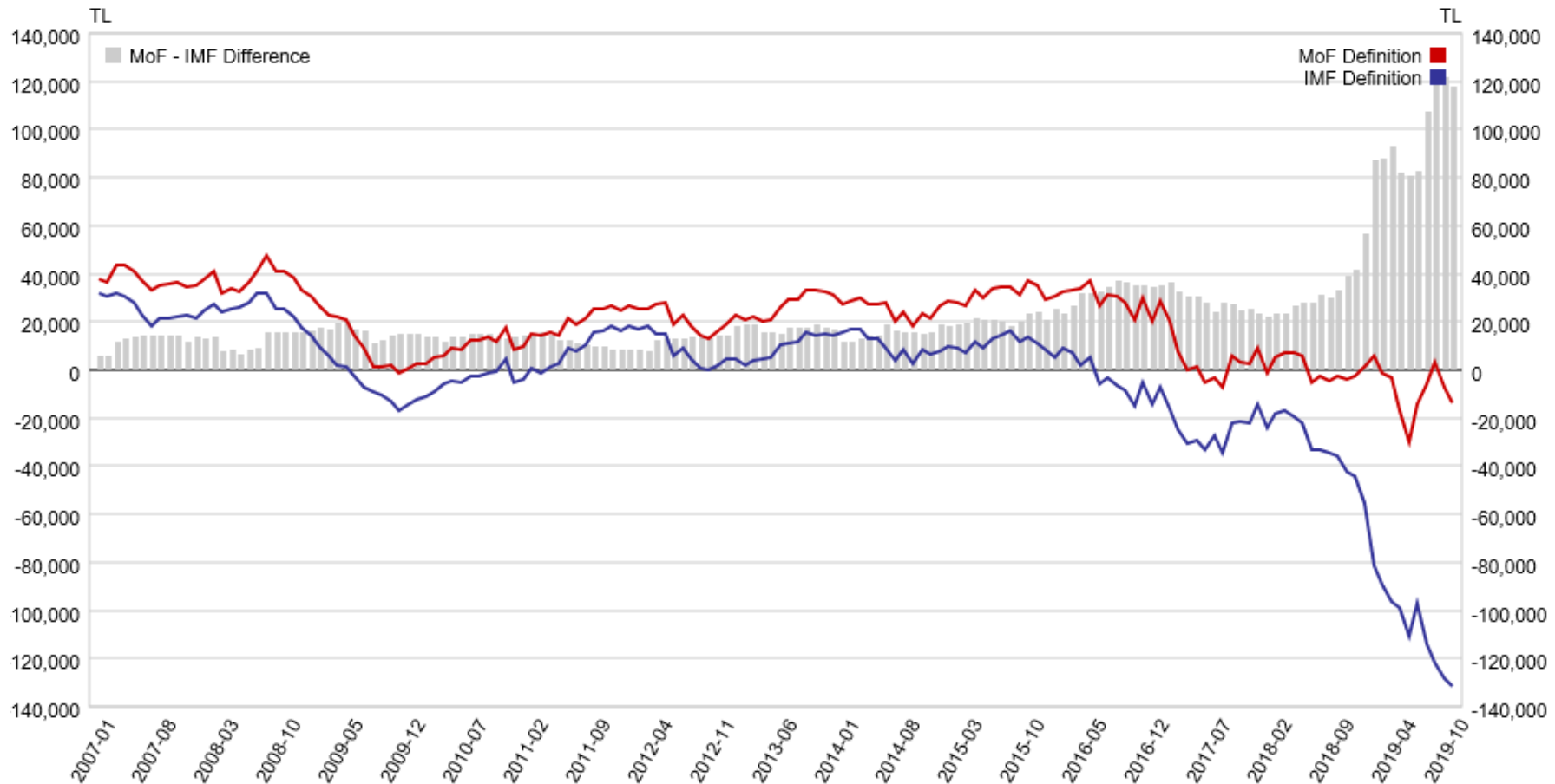


Source: Turkey Data Monitor

Central government budget balance

Central Government Primary Balance (million TL, 12-month rolling)

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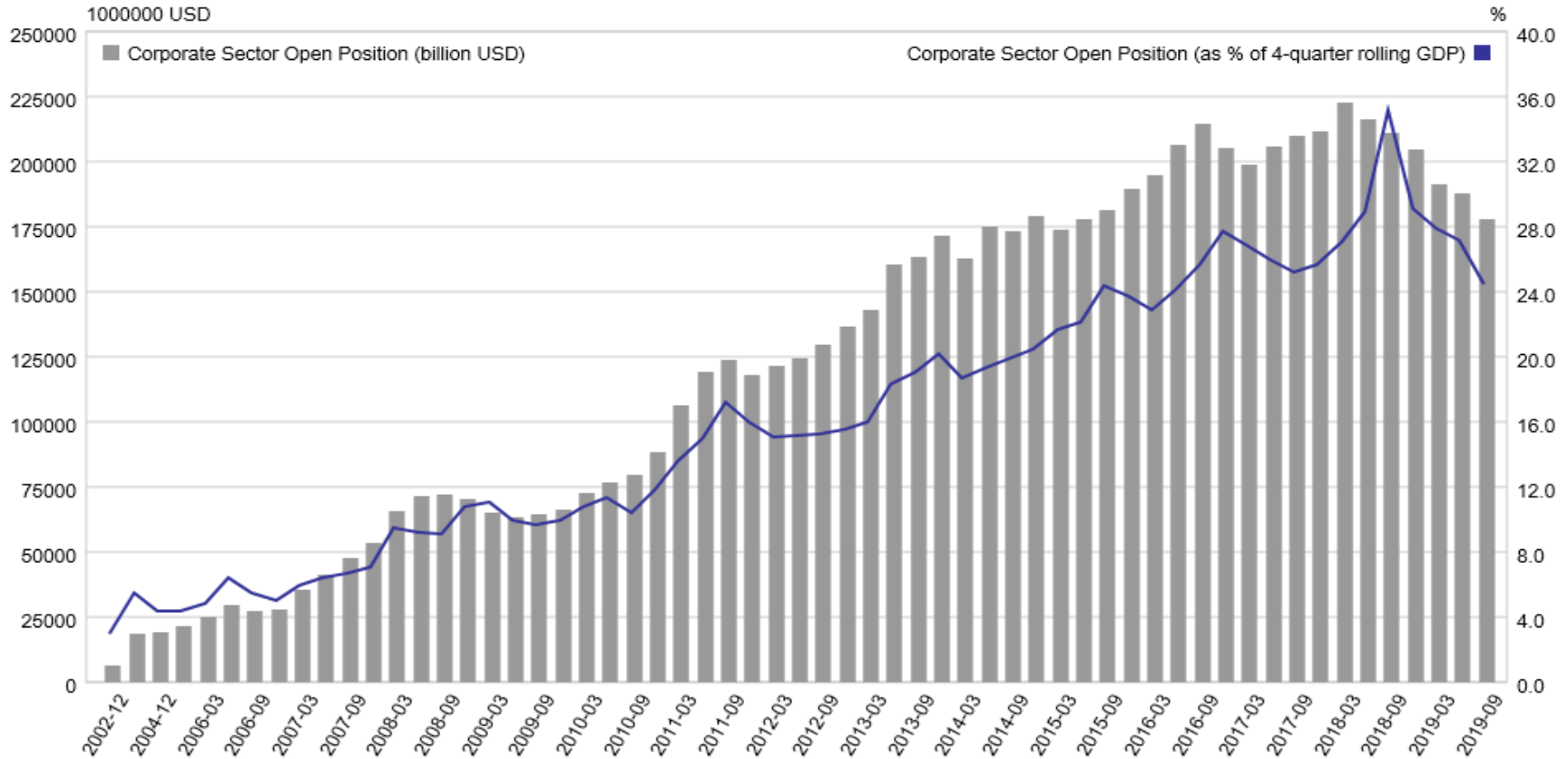


Source : Turkey Data Monitor

Corporate sector open position

- According to CBRT, corporate sector open position is 178 billion \$ (as of GDP: %24.5)

Corporate Sector Open Position



Source: Turkey Data Monitor

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