



# Bakış

**Macro Trends in Turkish and  
Global Economy**

Issue 4

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Contrary to popular belief, bats are not blind. Out of more than 1000 species, not even one species is blind, and some of them see well. The eyes of many small bat species are small and not that developed, but they are not blind. When small bats are flying long distances out of their echolocations, they use their visual senses to find their way. The look angle of the gatherer species is as wide as a mouse's. Some species are known to sense ultraviolet lights, and many species living in caves are known to have developed vision in very low light. Besides vision, their sense of smell and sense of hearing are also very developed.

Bats prefer to hunt at night, for the purposes of decreasing competition with birds, and to be able to fly long distances in search of food, sometimes reaching distances of up to 800 kilometers. The look angle of bigger bat species is not better than humans, but as good as humans. In contrast to small bats, this look angle is appropriate for both night and day vision, and enables them to see some shapes in colour, which are seen as obscure grey shadows by small bats.



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## General Outlook:

# With caution, without losing hope...

There are problems in the recovery of the global economy following the Great Recession. Last year, because of the increase in US dollar, many countries' currencies depreciated against US dollar, especially emerging economies. This caused a deterioration in the economic indicators of many countries. At the same time, global trade declined severely due to the appreciation of US dollar, declining to levels before the Great Recession.

These troubles from last year have also affected 2016. Because of these problems, in 2016, with the effect of the decline in the growth of emerging economies, especially China, Russia and Brazil, global economic growth is declining. Global trade is also similarly decelerating. According to estimations, growth in global trade in 2016 will be the lowest of the last 15 years, excluding the Great Recession.

For 2017, expectations are more optimistic. The global economy of 2017 is expected to perform better than 2016, due to the expectations of a slowdown in appreciation of US dollar and commodity prices starting recovering.

The Turkish economy is also being affected by the negativities in the global economy. Although the Turkish economy showed a good performance in the first half of 2016, for the remainder of the year our growth is slowing down especially due to losses in tourism. As was the case last year, Turkey's exports are decreasing in 2016 because export prices are declining, due to decreases in oil and commodity prices. Moreover, losses in tourism also cause net exports to contribute negatively to Turkey's growth. Due to developments throughout the year, the growth estimation for Turkey in 2016 was decreased from 4.5% to 3.2% in the Mid-Term Plan.

Following 2016, which has been a tough year for Turkey, expectations for 2017 are more optimistic. In the coming year, it is expected that Turkey will recover its losses in goods and services exports and a stronger growth is observed with the reform steps taken by the government.



# Global

In the first half of 2016, the global economy experienced the effects of 2015. Because oil and commodity prices were at low levels, countries whose economies are dependent on oil and commodities continued to shrink. However, in the second half of the year this effect vanished. Recently, inflation started to increase in EU countries and in the US, having also been affected by the removal of the base effect in oil and commodity prices. With the 2% inflation target of FED is up, the probability of an interest rate increase in December following the November elections is increasing.

In the Eurozone, a recent topic for the agenda is that the European Central Bank (ECB) will decrease and eventually end (tapering) the bond-buying program, which currently has a monthly volume of 80 billion euros. With the decreasing downwards pressure of oil and commodity prices, inflation in the Eurozone has been increasing since

April. As the target of 2% inflation is about to seize, the ECB is thought to be implementing this policy. The ECB starting the tapering process, euro will enter an appreciation period in the upcoming days.

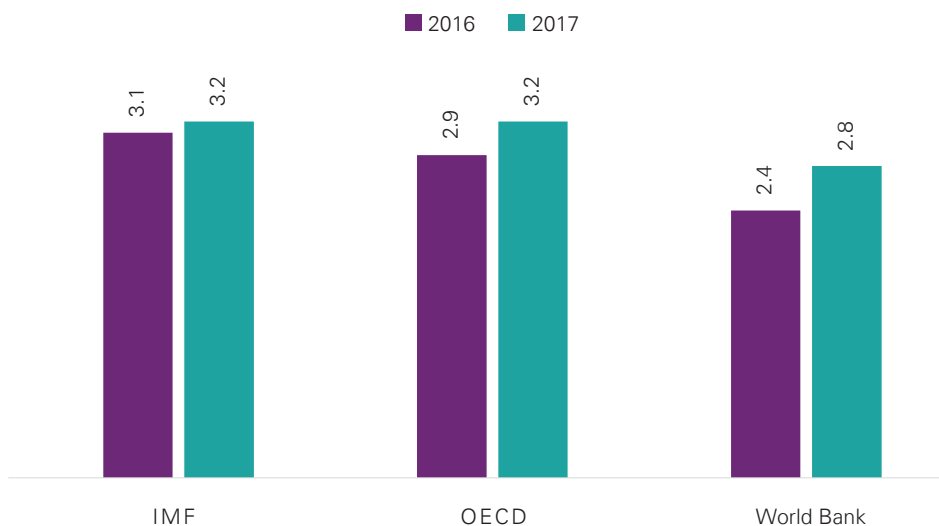
Meanwhile, the Chinese economy continues to decelerate in growth. Last year, China faced the biggest slowing down of the last 25 years with annual growth rate falling to 6.9%. This year, China is expected to grow 6.6%. Global trade continues to weaken, due to a slowing Chinese economy and a low level in commodity prices.

Finally, the World Trade Organization (WTO) decreased their expectation of growth in global trade for 2016 to 1.7% from 2.8%. This will be the lowest growth rate of the last 15 years, excluding the Great Recession. However, in 2017 global trade is expected to recover, thanks to the prospective recovery in oil and commodity prices.

# The global economy will show its lowest growth since the Great Recession.

- 📄 In 2009, which was the year most affected by the Great Recession, the global economy shrank by 0.1%.
- 📄 Even if the world economy entered a recovery phase following the Great Recession, now global economic growth is declining, due to factors such as
  - the debt crisis of 2012 in the Eurozone,
  - severe falls in oil and commodity prices due to an appreciating USD beginning with the second half of 2014,
  - the effect of the decline in the growth of emerging economies, especially China, Russia and Brazil.
- 📄 For 2017, expectations are more optimistic. The global economy is expected to perform better than 2016, due to the expectations of a slowdown in the appreciation of USD and commodity prices starting recovering.

## Global Growth Expectations (%)



Source: IMF World Economic Outlook



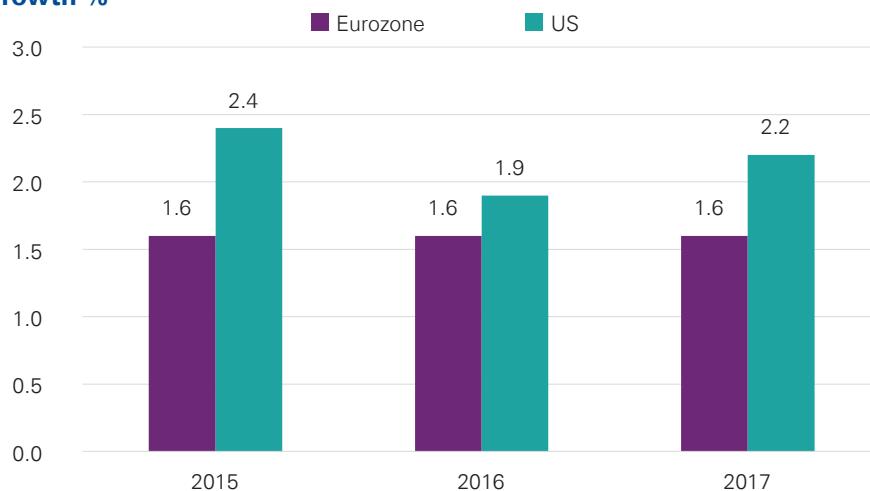
# A FED interest rate increase is approaching...

## In the EU, tapering is on the agenda

Recently, inflation started to increase in EU countries and the US, having also been affected by the removal of the base effect in oil and commodity prices. With the 2% inflation target of FED approaching, the probability of an interest rate increase in December following the November elections is increasing. Lately, the expectation of markets for an interest rate increase in December is above 60%. As for growth, with the additional effect of stagnation in the global economy, a lower growth is expected than the estimates made at the beginning of the year. According to the World Bank, the US will grow 1.9% in 2016.

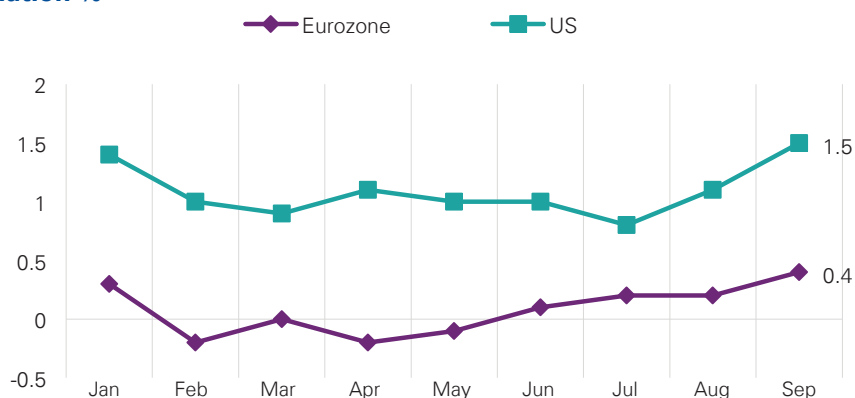
In the Eurozone, a recent topic for the agenda is that the ECB will decrease and eventually end (tapering) the asset purchase program, which currently has a monthly volume of 80 billion euros. With the downwards pressure effect of oil and commodity prices decreasing, inflation in the Eurozone has been increasing since April. As the target of 2% inflation is approaching, the ECB is thought to be implementing this policy. The ECB starting the tapering process will cause the euro to enter an appreciation period.

### Growth %



Source: World Bank

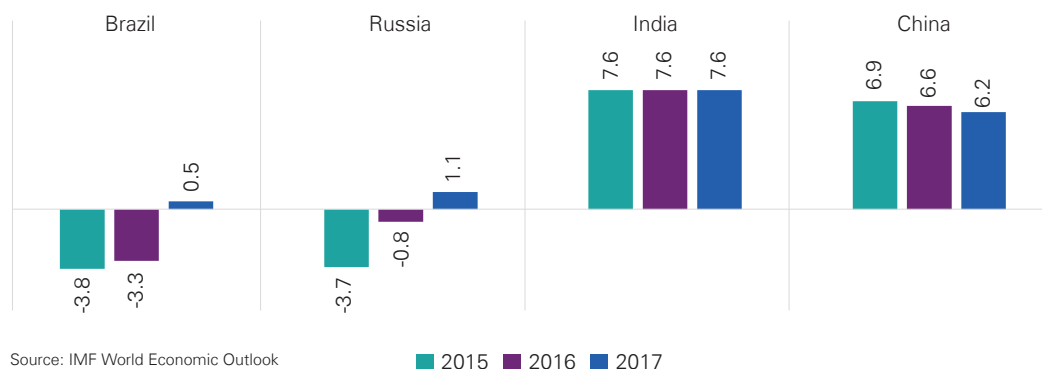
### Inflation %



Source: Trading Economics

# 2016 not going well for emerging economies just like in 2015

## Growth %



## A weak performance of emerging economies continues in 2016.

**China:** The Chinese economy performed its worst of the last 25 years with a growth rate of 6.9% in 2015. In 2016, it is expected to grow even lower, at 6.6%, while in the third quarter growth was 6.7%. For 2017, estimates lean towards a 6.2% growth in China, meaning lower performance.

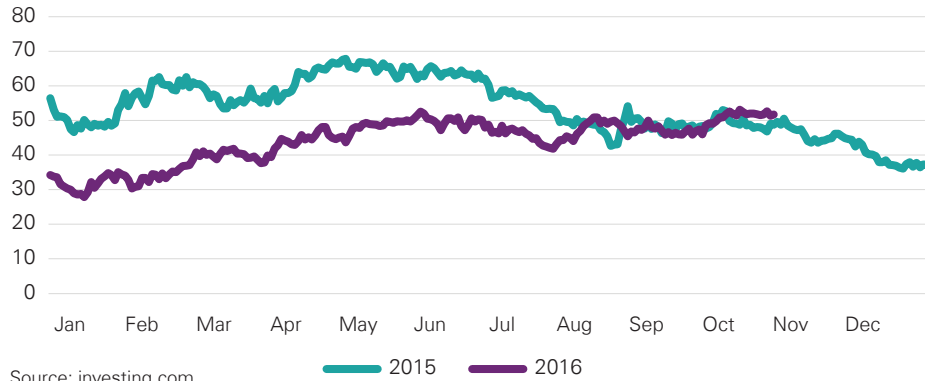
**India:** Among the BRIC countries, India is the country with the best economic performance. It is anticipated to grow at 7.6% in 2016 and 2017. However, in India, which is a major oil importing country of the world, with the base effect in oil prices now worn off, inflation reached its highest level in the last 2 years. And in the second quarter growth was 7.1%, below expectations.

**Russia:** The Russian economy has been shrinking since the first quarter of 2015 and it is expected to continue to shrink in 2016. However, with the moderate moves in oil prices it is anticipated that the Russian economy will return to growth in 2017.

**Brazil:** Low levels of commodity prices and high levels of government debt continued to trouble the Brazilian economy. The Brazilian economy shrank by 5.4% and 3.8% in the first two quarters respectively, and is expected to shrink by 3.3% by the end of year. However, regarding the other countries, the recovery of commodity prices will provide recovery for the Brazilian economy in 2017.

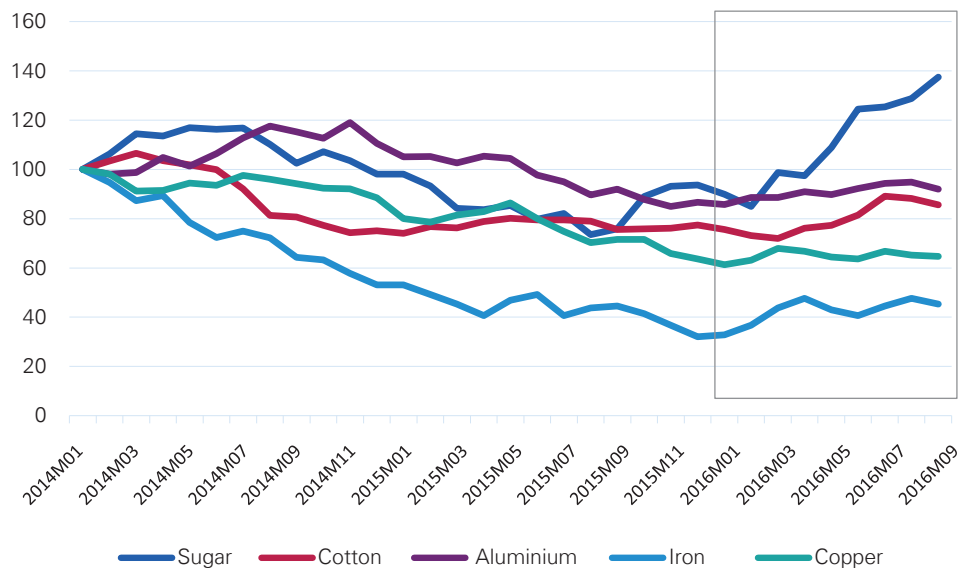
# For oil and commodity prices, base effect has worn off

## Brent Oil (USD/BBL)



Since the beginning of 2016, oil prices are in an upward trend. With the appreciation of USD coming to an end, and OPEC member countries discussing precautions to limit supply during the year, oil prices continued to increase in the last period. Finally, with the expectation that OPEC members will limit supply, the World Bank raised its oil price estimate for 2017 to 55 USD.

## Commodity Price Index (2014 January=100)



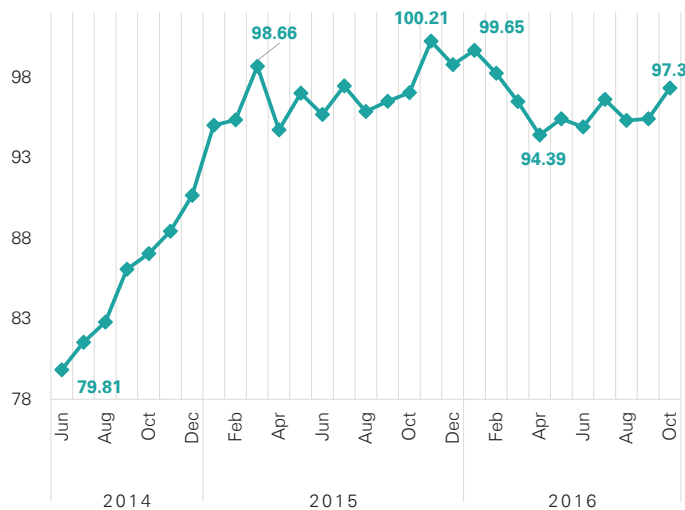
In 2016 commodity prices move inversely to USD, like oil prices; both are in the recovery period. But in many metal groups, such as iron, aluminium and copper, prices are still below 2014 levels.

# USD began to get stronger, with the expectations of a FED interest rate increase in December

US Dollar, which appreciated beginning with the second half of 2014 globally, entered a depreciation trend in 2016, with the expected interest rate increases not being realized. The index which was at the 99.65 level at the beginning of 2016, reached the lowest level of 2016 in April with 94.39. Lately, with the increasing expectations that FED will increase interest rates in December, the index moved upwards.

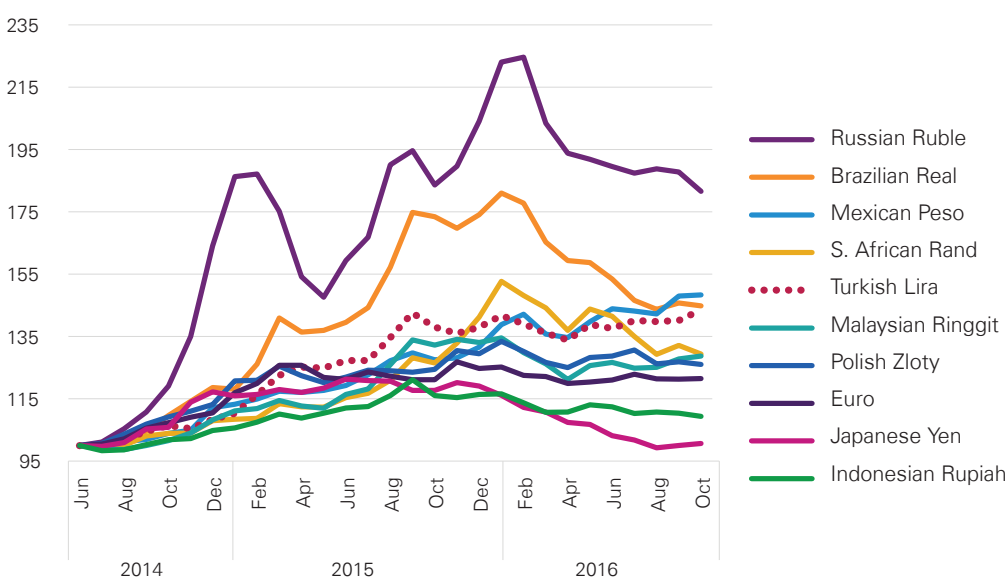
Estimates generally point to USD appreciating until the end of year. While USD was depreciating in 2016, other currencies appreciated against USD. Currencies which were depreciated highly against USD in the second half of 2014, such as the Russian Ruble, Brazilian Real and South African Rand, appreciated against USD, while the Mexican Peso and Turkish Lira continued to depreciate due to internal issues.

**USD Index**



Source: investing.com

**Index values of currencies against USD (June 2014=100)**



# Global trade showed a very weak performance in 2016

- Because of the weakness in the global economy, global trade is showing the weakest performance of recent years in 2016. Finally, the World Trade Organization (WTO) decreased their expectation of growth in global trade for 2016 to 1.7% from the original 2.8%. This will be the lowest growth rate of the last 15 years, excluding the Great Recession.
- Since 1990, the growth in global trade was double the global growth rates. Now, the global trade growth rate is below global GDP growth.
- At the same time, a decline in global trade in USD terms continues in 2016. In the first 8 months, global trade fell by 4.4%. According to estimates, global trade, which decreased to 16.5 trillion USD in 2015, is expected to be approximately 16 trillion USD as of end of 2016.
- On a country basis, in the first 8 months, US exports declined by 5.6%, while imports declined by 4.4%.
- In the same period, EU exports and imports decreased by 0.8% and 0.4% respectively, while Russian exports decreased by 25.7%, and imports by 5.6%.
- According to the data of the first 9 months, Chinese exports decreased by 7.5% and imports by 8.2%.

## Declines in 2016 global trade

|   | Exports       | Imports      |
|---|---------------|--------------|
|    | <b>-4.4%</b>  |              |
|    | <b>-5.6%</b>  | <b>-4.4%</b> |
|    | <b>-7.5%</b>  | <b>-8.2%</b> |
|   | <b>-0.8%</b>  | <b>-0.4%</b> |
|  | <b>-25.7%</b> | <b>-5.6%</b> |

Source: World Trade Organization





# Turkey

Turkey entered a period of rapid growth following the Great Recession, but slowed down in 2012. Although a recovery was realized in 2013, low growth was observed in 2014, followed by an increasing growth trend in 2015. The Turkish economy, which started the first quarter of 2016 with a good performance, achieved a good rate of 3.1% in the 2nd quarter despite all risks.

Although Turkey performed well in growth in the first half of 2016, it seems to have difficulty in maintaining this performance for the remainder of the year. The effect of losses in tourism will be much intense in the third quarter. And in the fourth quarter, approximately 3% growth is expected with the recovery of domestic consumption. Regarding the current account deficit, despite the positive look in foreign trade balance, it has started to increase again lately, due to losses in tourism. As of the end of 2015, the current account deficit / GDP ratio was 4.5%, and it declined to 4.2% in the second quarter of 2016. We anticipate that this ratio will increase to 4.9% at the end of the year.

To boost growth, CBT recently decreased the upper band of the interest corridor 7 times. The weighted funding cost was at 8.9% when CBT started these cuts, now it has decreased to 7.75%. However, deposit interest rates and Turkey's risk premium are at high levels, and this causes high international borrowing costs for banks which, in turn, prevents a fall in loan interest rates.

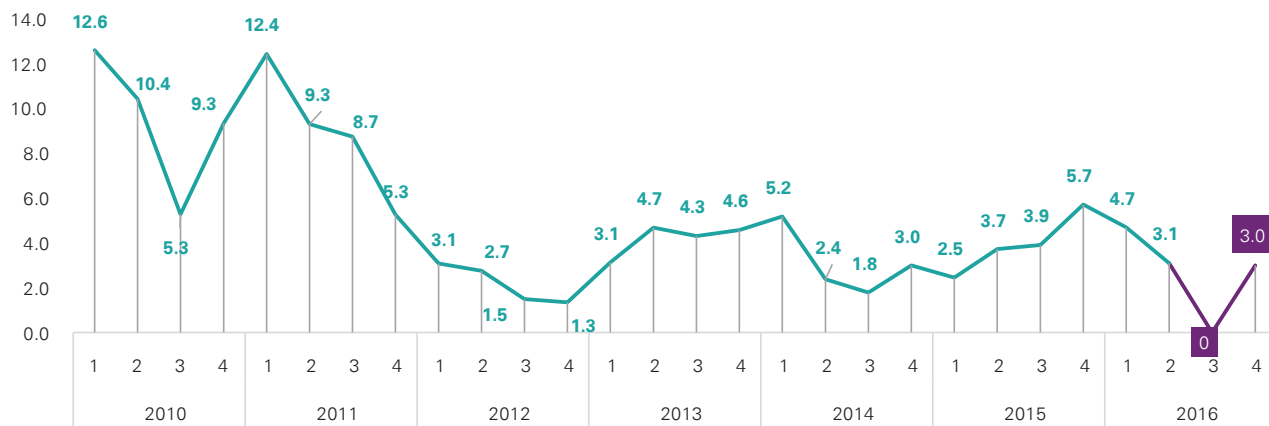
At the same time, parallel to appreciation of USD, there has been deteriorations in Turkey's foreign debt structure. Even in the last period, short term debt volume has decreased, the ratio of total foreign debt to GDP reached 59.5% in the second quarter of 2016, which is the highest level since 2002. S&P and Moody's referred to the weakness in this indicator when cutting Turkey's credit rating. Inflation has fallen recently, due to decreases in food prices.

According to the Medium Term Program which was revised because of the developments throughout the year, growth expectation was modified to 3.2%, from 4.5%. And for 2017, growth expectation decreased to 4.4% from 5%. The Turkish economy is expected to perform better in 2017, like the global economy.

# Growth will slow down in the second half of the year

- Turkey has been growing at an average of 5% for the last 27 quarters.
  - Turkey entered a period of rapid growth following the Great Recession, but slowed down in 2012. Although a recovery was realized in 2013, low growth was observed in 2014, followed by an increasing growth trend in 2015. The Turkish economy, which started the first quarter of 2016 with a good performance, achieved a good rate of 3.1% in the 2nd quarter despite all risks.
  - Although Turkey performed well in growth in the first half of 2016, it seems to have difficulty in maintaining this performance for the remainder of the year.
- The effect of losses in tourism will be much more intense in the third quarter. Moreover, both Ramadan and Eid Al-Adha were celebrated in the third quarter, and there were 9 days' holidays in both celebrations. For this reason, industrial production data also shows a decline. In the first 2 months of the third quarter, industrial production declined by 2.7%. September industrial production data being negative is a high probability. Therefore, the growth figure for the third quarter will be somewhere near zero. And in the fourth quarter, approximately 3% growth is expected with the recovery of domestic consumption.

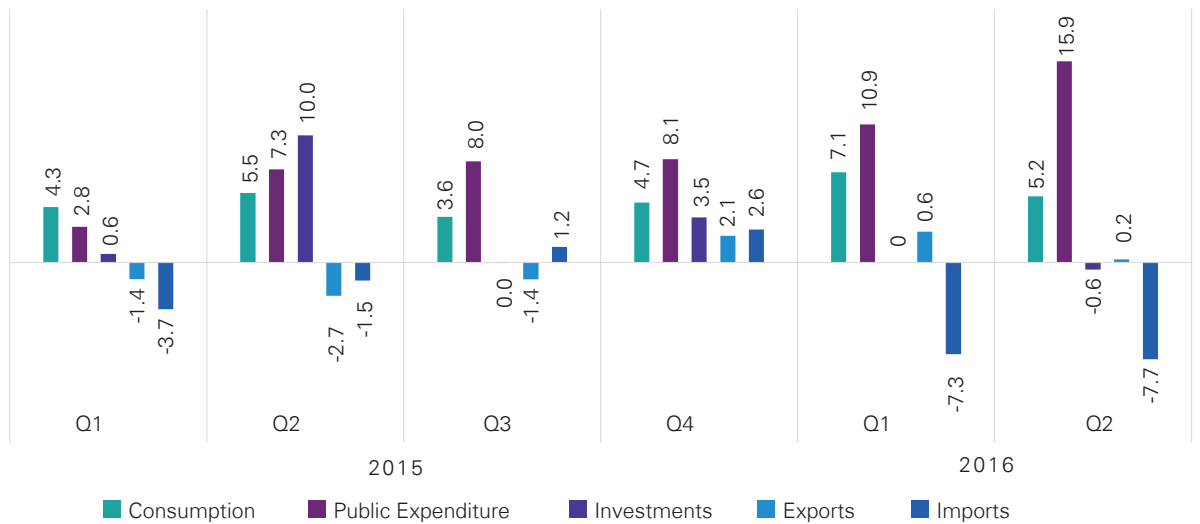
## Turkey 2010-2016 growth rates



Source: TÜİK (Turkish Statistics Institute)

# Domestic demand continues to be the main driver of growth

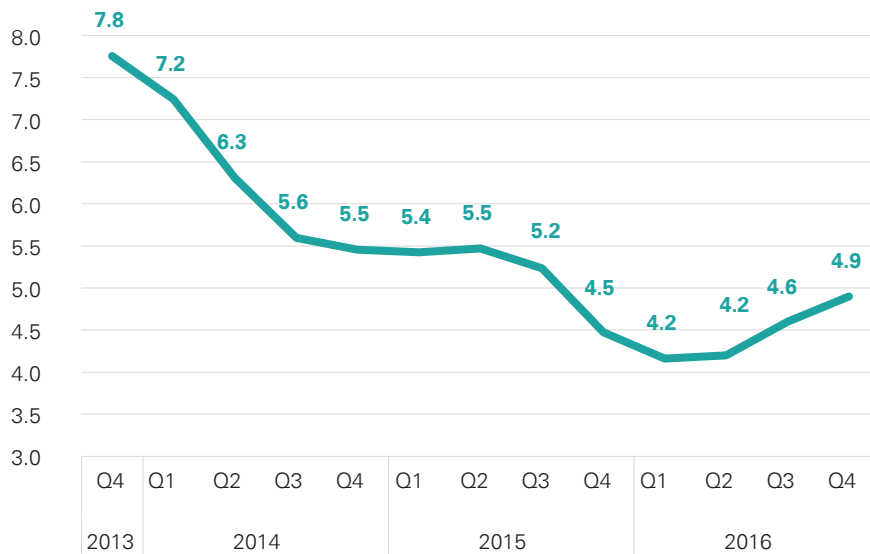
- In 2016, again, growth continues to move with the significant contribution of domestic demand.
- Domestic demand contributed 5.9 points to growth in the first quarter and 5 points in the second quarter. Net exports contributed negatively 1.54 points to growth in the first quarter due to real imports increasing significantly and tourism losses. The negative contribution in the second quarter was 2.1 points.
- Regarding the third quarter, we expect net exports to contribute negatively to growth again, due to the more intense effects of the losses in tourism.



- The fact that investments have been stagnant for the last two quarters also has an adverse effect on the composition of growth. While Turkey's growth needs to be mainly from net exports and investments, the fact that it is now growing by domestic consumption is a problem for the future. However, with the structural reforms brought by the government and packages launched, we expect investments to accelerate beginning with the last quarter.

# The current account deficit declined in the first half of the year but will start to increase in the second half

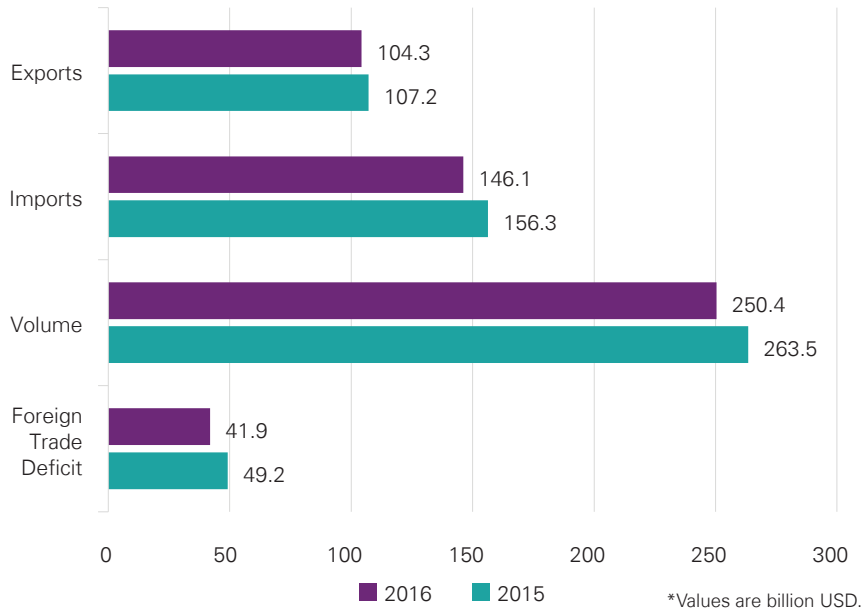
## Current Account Deficit / GDP (%)



Source: TÜİK, CBT

- The current account deficit declined in 2015 by **26.3% compared to last year, from 43.6 billion USD to 32.1 billion USD**. Recently, in August, the level was at 31 billion USD.
- The current account deficit, which was at its lowest level in April at 27.7 billion USD, started to increase again in the following months due to losses in tourism.
- As of the end of 2015, the current account deficit / GDP ratio was **4.5%**, and it declined to 4.2% in the second quarter of 2016. **We anticipate that this ratio will increase to 4.6%** in the third quarter.
- With the base effect in oil and commodity prices wearing off, it is expected that the current account deficit will continue to increase, starting from October. It is anticipated that losses in tourism will remain at similar levels for the 4 months following August. Therefore, **we anticipate that the current account deficit will move upwards in the second half of the year, and will be approximately 35 billion USD at end of year.**
- With the expectation that GDP at end of year will be approximately 715 billion USD due to the appreciation of USD, we expect that the current account deficit / GDP ratio will be 4.9%.

# The foreign trade deficit declined, due to low energy prices



- In the first 9 months of 2016, exports totaled 104.3 billion USD, decreasing by 2.7%. Exports by volume increased by 5%.
- Imports decreased more than exports by 6.5%, to 146.1 billion USD.
- In this period, the foreign trade deficit decreased by 14.8%, to 41.9 billion USD.
- Oil and commodity prices being less than they were for the same period of the previous year was the factor in the decline of the foreign trade deficit.
- Excluding energy, imports shrank, not by 6.5%, but only 0.3%. This was again by the cost decreases in energy resources, thus import prices declining.
- Factors in the decline of exports were low level export prices, as with the case with imports, the armed conflict in Iraq, and the political crisis with Russia.

# Export of goods - Countries

| Million USD     | 2015* | 2016* | Change (%) |
|-----------------|-------|-------|------------|
| Germany         | 8 632 | 9 148 | 6          |
| UK              | 6 996 | 8 215 | 17.4       |
| Iraq            | 5 807 | 4 715 | -18.8      |
| Italy           | 4 351 | 4 771 | 9.6        |
| Switzerland     | 4 317 | 2 353 | -45.5      |
| USA             | 4 221 | 4 322 | 2.4        |
| France          | 3 740 | 3 944 | 5.4        |
| UAE             | 3 475 | 2 960 | -14.8      |
| Spain           | 3 088 | 3 290 | 6.5        |
| Iran            | 2 447 | 3 360 | 37.3       |
| Russia          | 2 432 | 980   | -59.7      |
| Saudi Arabia    | 2 429 | 2 142 | -11.8      |
| Egypt           | 2 027 | 1 825 | -10        |
| The Netherlands | 2 019 | 2 409 | 19.3       |
| Romania         | 1 802 | 1 782 | -1.1       |

Source: TÜİK \*January-August

In the first 9 months of 2016, European Union countries were the main drivers of exports. In this period, exports to EU countries increased by 5.4%, compared to the same period last year.

The biggest increase of exports among EU countries was Bulgaria with 35.8% and the Netherlands with 19.3%. Exports to our biggest export partner Germany increased by 6%, while exports to the UK, which was shaken by the decision to exit the EU, increased by 17.4%. But this increase carries with it the effect of non-monetary gold exports. Excluding gold, our exports to the UK decreased by 7.5%. Meanwhile, exports decreasing to Switzerland by 45.5% and to the United Arab Emirates by 14.8% were also affected by gold exports to these countries being at smaller levels.

Among the top export countries of 2015, the biggest loss was to Russia. In the first 9 months, our exports to Russia decreased by 59.7%. In another significant and troubled market, Iraq, exports decreased by 18.8% in the same period.



# Number of tourists decreased by 8.1 million in the first 8 months

Losses in the number of visiting tourists had a serious effect in the third quarter. The number of tourists travelling to Turkey was 17.4 million between January-August 2016, decreasing by 31.8% year-on-year. This means a decrease of approximately 8.1 million tourists. **Regarding our biggest competitors in tourism, tourists travelling to Spain increased by 10.1%, while tourists travelling to Greece decreased by 1.6% in the first 6 months.**

In the first 8 months of the year, we experienced the biggest loss in the number of tourists from Russia, with 87.9%. In this period, tourists travelling from Russia decreased by 2.4 million. The biggest loss in number after Russia was Germany. In this period, German tourists travelling to our country decreased by 1 million persons. Among the top 10 countries travelling to Turkey as tourists in 2015, only the numbers from Georgia increased. There were severe losses from Iraq, the United Kingdom, France and the Netherlands.

Losses in the number of tourists affected Turkey's tourism revenues in similar proportions. Again, in the first 8 months, Turkey's tourism revenues were 12.2 billion USD, decreasing by 31.4%. This means a loss of approximately 5.6 billion USD. It is anticipated that losses in tourism will be at similar numbers for the 4 months following August. Last year, our tourism revenues were at the 8.8 billion USD level in the September-December period. This year, tourism revenues are expected to decline to 6.2 billion USD in the same period.

Thus, at the end of year, the total tourism loss is anticipated to be over 8 billion USD.

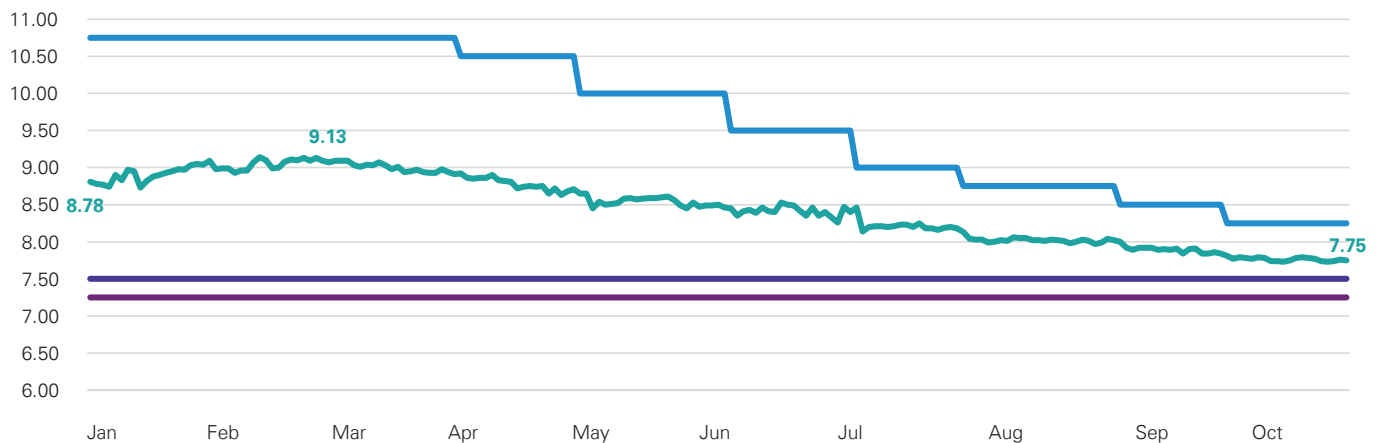
| Million USD     | 2015*     | 2016*     | Change (%) |
|-----------------|-----------|-----------|------------|
| Germany         | 3,750,082 | 2,714,861 | -27.61     |
| Russia          | 2,779,343 | 336,165   | -87.90     |
| UK              | 1,802,629 | 1,246,490 | -30.85     |
| Georgia         | 1,230,017 | 1,466,849 | 19.25      |
| Iran            | 1,202,001 | 1,117,907 | -7.00      |
| Bulgaria        | 1,181,236 | 1,096,972 | -7.13      |
| The Netherlands | 933,516   | 704,354   | -24.55     |
| Iraq            | 702,430   | 244,939   | -65.13     |
| France          | 643,356   | 427,835   | -33.50     |

Source: Ministry of Culture and Tourism Number of Persons, \*January-August

# CBT gave a break to interest rate cuts in October

- Since March, CBT has decreased the upper band of the interest rate corridor 7 times. Finally, in the Monetary Policy Board of October, the decrease period came to an end and interest rates did not change, due to the depreciation in TRY.
- The weighted funding cost was at 8.9% when CBT started these cuts, now it has decreased to 7.75%. However, weighted funding cost, which was moving in tandem with the policy interest rate until the beginning of 2015, is now at approximately 25 basis points above the policy interest rate.
- CBT is expected to continue simplification steps in monetary policy in the coming months, according to conditions, and is expected to switch to a single interest rate.

## CBT Interest Rates (2016 - Current)

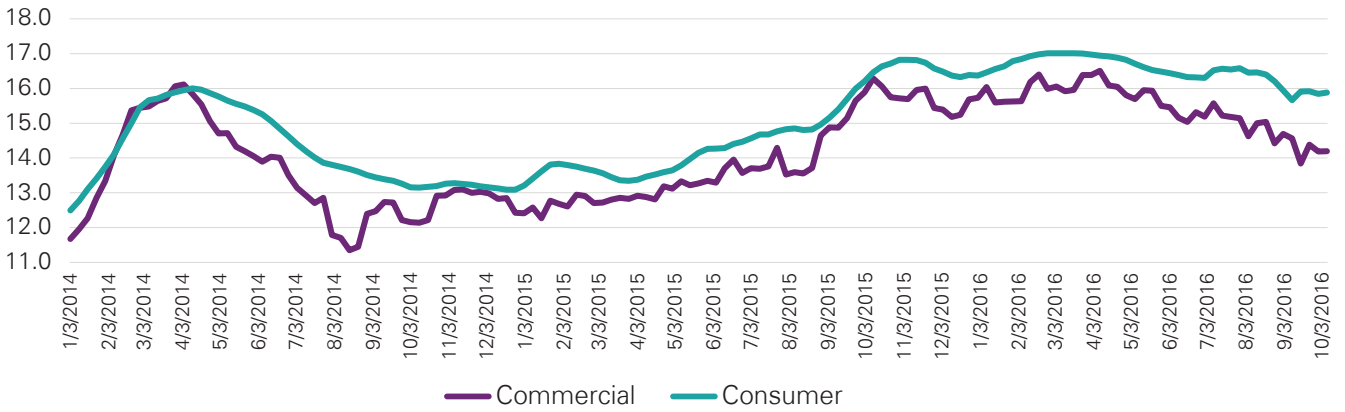


Source: CBT

Weighted Average    Overnight Borrowing    Overnight Lending    Weekly Repo

# There was a limited decline in loan interest rates, despite CBT decreases interest rates

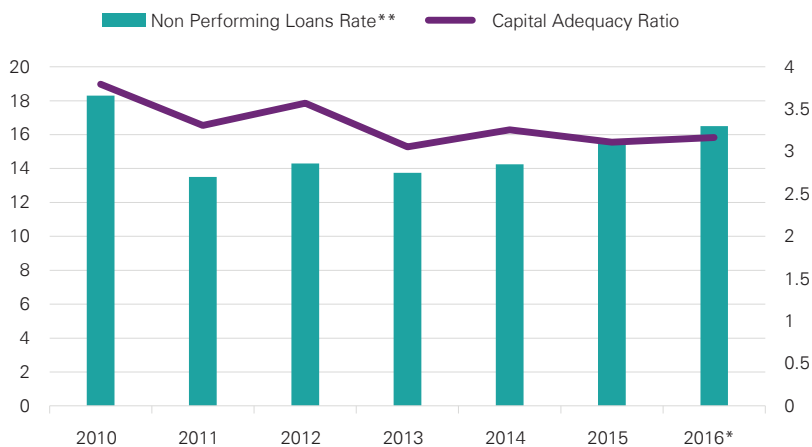
Loan interest rates (monthly average)



Source: CBT

- 📄 In the last period, CBT made cuts in the upper band, and the weighted funding cost is decreasing. However, deposit interest rates and Turkey's risk premium are at high levels, and this causes high international borrowing costs for banks which, in turn, prevents a fall in loan interest rates.
- 📄 However, there was still a downward move in bank loan interest rates with the interest rate decreases in the last period. The downward move in question is more significant in commercial loans than consumer loans.
- 📄 Since March, when interest rate cuts started, commercial loans decreased by 2 points and consumer loans decreased by 1 point.
- 📄 Finally, consumer loan interest rates are at an average level of 15.6%, while commercial loan interest rates are at 15% .

# Banking indicators got worse, due to appreciation of USD



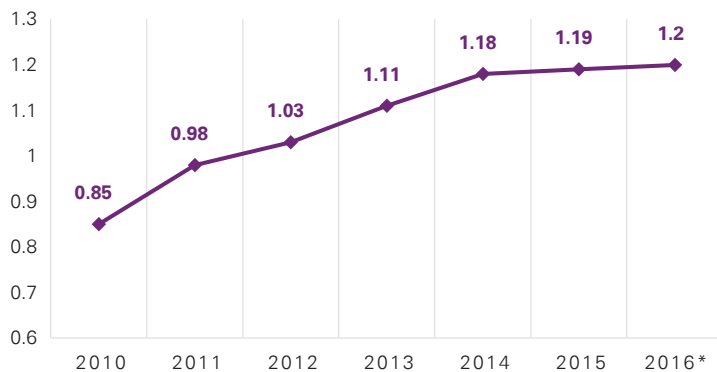
Source: BRSA  
\*June-end data \*\*Right axis

Since the second half of 2014, with USD appreciating across the entire world, the USD/TRY exchange rate increased from 2.1 levels to 3 levels. As the result of such a high increase, the numbers of private sector which has USD denominated debt, and of the banking sector, deteriorated.

The non-performing loan rate of the banking sector reached 3.3%, the highest level since 2010. The non-performing consumer loans rate reached 4.35% as of June 2016. This rate had increased to 6% in 2009. Moreover, the capital adequacy ratio of the banking industry is at lower levels compared to previous periods. According to Basel criteria, this ratio must be at a minimum level of 8%. The current ratio is much higher than this level. Moreover in 2016 this ratio being increased, compared to the end of 2015. So, for now there appears to be no serious problem with the capital adequacy ratio.

A problematic indicator is the ratio of loans to deposits. As of June 2016, this ratio stands at 1.2%. This means that banks are extending loans on amounts that are higher than the deposits they receive. This signals that the cross border debts of banks have been increasing.

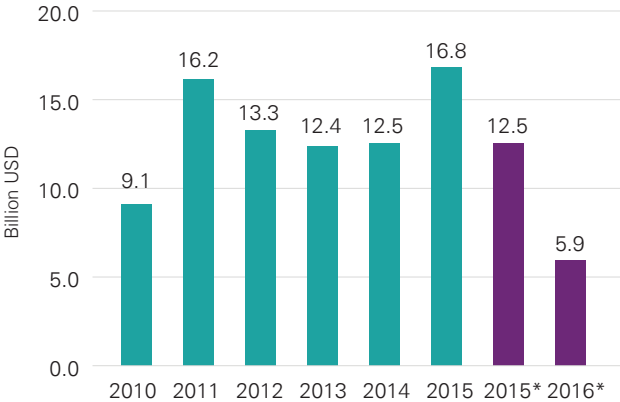
## Loans/Deposits Ratio (%)



Source: BRSA  
\*June-end data

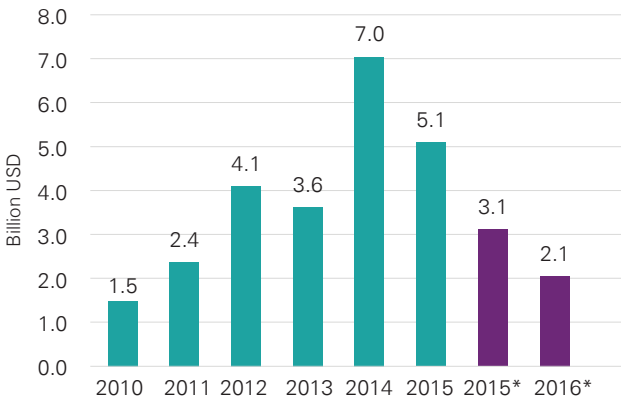
# Foreign direct investments slowed down in 2016

**FDI Inflow**



Source: CBT \*January-August

**FDI Outflow**



Source: CBT \*January-August

- Foreign direct investment to Turkey reached its highest level following the Great Recession in 2015, with 16.8 billion USD. Investments into Turkey in 2015 increased by 34%, compared to 2014.
- While flow of foreign direct investment decelerated in 2016 across the globe, with the effects of terrorist attacks and the coup attempt of July 15th, a severe decrease occurred in foreign investment inflow. In the first 8 months, FDI inflow

to Turkey was 5.9 billion, showing a decline of 52.7%. Similarly, FDI outflow from Turkey was 2.1 billion USD, showing a decline of 34%.

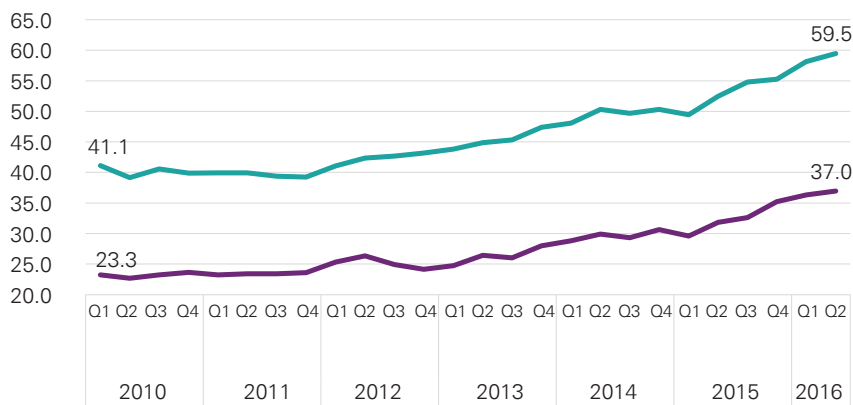
In the decrease of the FDI inflow to Turkey in 2016, a decline in investments from America and Asian countries was effective. Even though investments from European countries declined, the share of European countries in total FDI increased from 60% to 67%.

# Foreign debt is increasing, but short term debt is decreasing

As of the 2nd quarter of 2016, Turkey has:

- a public external debt of 121.5 billion USD
- a private external debt of 298.8 billion USD
- a gross external debt of 421.4 billion USD

## External Debt / GDP (%)



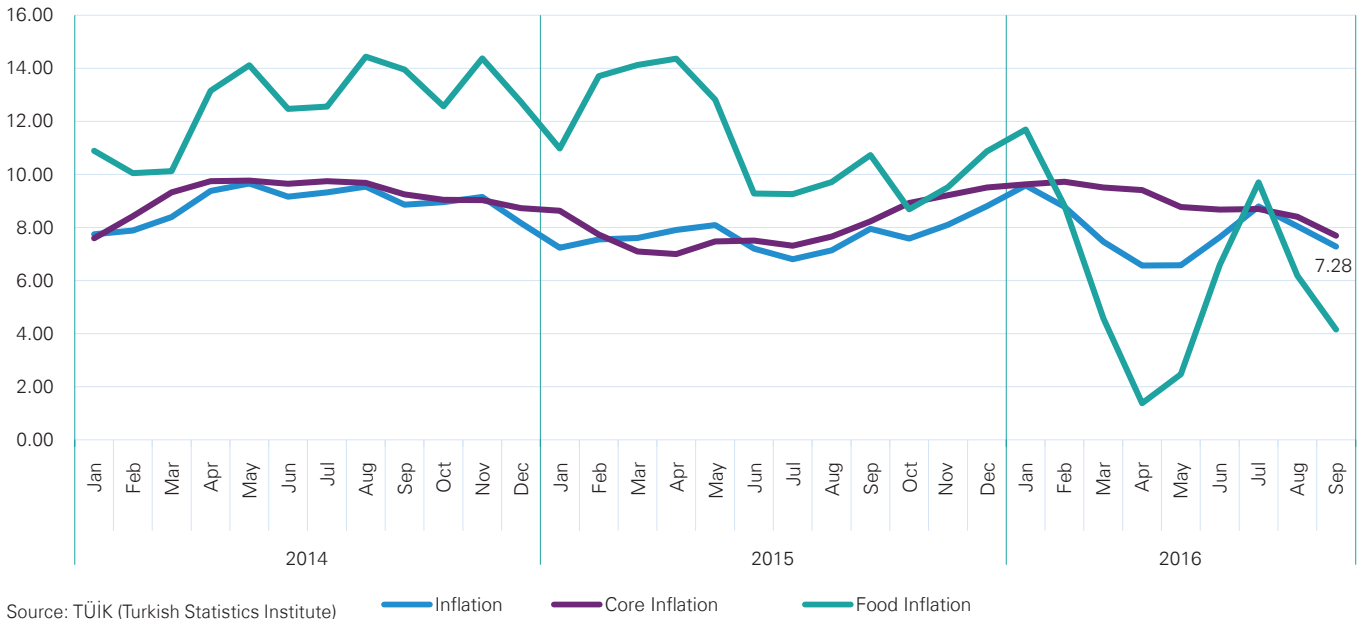
Source: Undersecretariat of Treasury

- With the precautions of the CBT in 2015, the ratio of short term debt to total debt has decreased from 32.7% to 25.5%, since the end of 2014.
- The gross external debt / GDP ratio of Turkey reached its highest level in 2001 at 57.7%, and its lowest level in 11 years in 2005 at 35.5%. In the 2nd quarter of 2016, the ratio reached its highest level since the 2nd quarter of 2002 at 59.5%. The net debt / GDP ratio increased similarly in the last period, in severe numbers, and as of the 2nd quarter of 2016 reached its highest level since 2003 at 37%.
- These ratios are designated as risks for the Turkish economy by international rating agencies. The decrease in USD based GDP due to the appreciation in USD was a factor for the increase in these ratios. Although the debt to GDP ratio has increased, it is a positive development that the share of short term debt has fallen. In the coming period, we expect this ratio to decline, with the appreciation of USD stabilizing.



# There is a decline in inflation driven by food

## Inflation Indicators (%)



Source: TÜİK (Turkish Statistics Institute)

- 📄 Inflation, which was at high levels in 2014 and 2015, went through a downward trend in the beginning of 2016. But it started to increase in May. Afterwards, it declined again, down to 7.28% in September.
- 📄 Recent high levels of volatility in food prices have been a major factor in the fluctuation of inflation. Because the weight of food in inflation basket is 24% - the item with the biggest share, volatility in food prices affects general price levels severely.
- 📄 The most positive development in inflation lately has been the decline in core inflation. Core inflation, which is closely monitored by CBT for interest rate cuts, was 7.7% in September, this being its lowest level over the last year. This signals that interest rate cuts may continue in the coming period.

# Credit rating agencies

| FITCH (BBB-)    | MOODY'S (Ba1) | S&P (BB)      |
|-----------------|---------------|---------------|
| Bulgaria        | Azerbaijan    | Bahrain       |
| Indonesia       | Morocco       | Brazil        |
| Morocco         | Guatemala     | Guatemala     |
| The Philippines | Costa Rica    | Cyprus        |
| South Africa    | Hungary       | Croatia       |
| India           | Paraguay      | Paraguay      |
| Hungary         | Portugal      | <b>Turkey</b> |
| Namibia         | Russia        |               |
| Romania         | <b>Turkey</b> |               |
| Russia          |               |               |
| <b>Turkey</b>   |               |               |
| Uruguay         |               |               |

Source: datasmacro.com

- Because applications related to the state of emergency following the July 15th coup attempt have increased political risks in Turkey, the S&P was the first to cut Turkey's credit rating on July 20th, followed by Moody's on September 23rd.
- As a result, Turkey was declassified from a group of countries with a BB+ rating, such as Portugal, Azerbaijan and Russia, to a group of countries with a BB rating, such as Bahrain, Brazil and Paraguay. S&P granted the same rating to Turkey in February 2010, then raised it to BB+ in March 2013.
- Moody's was not in a hurry like S&P, but still cut Turkey's rating to Ba1 from Baa3 following the revision. So Turkey joined countries such as Azerbaijan, Russia, Portugal and Morocco. Moody's had been gradually increasing Turkey's rating since 2005. Turkey's rating was Ba3 in 2005. It was raised to Ba2 in January 2010, to Ba1 in June 2012 and finally to Baa3 in May 2013.
- With the rate cut by Moody's, Turkey lost its position in the investment grade category. This caused the Turkish Lira to depreciate against world currencies in the last period, and will continue to affect it likewise.
- According to Fitch, Turkey is still at investment grade.

# Why did Moody's cut Turkey's credit rating?

After Moody's cut Turkey's rating, commentators suggested that the decision was not economical but political. Looking at the explanations from Moody's, we see that the grounds for the decision were political as well as economical.

Moody's lists their economical reasons as follows:

## **The foreign financing requirement of Turkey is increasing continuously.**

Because of the recent terror incidents in big cities and the adverse effect of the Russia crisis on exports and tourism, the current account deficit is above expectations. Moreover, the foreign debt amount that has to be paid within 1 year is 155.8 billion USD. Therefore, the ratio of current account deficit and foreign debt payable to GDP will be at 26% in 2016 and 2017. This ratio being high increases Turkey's vulnerability.

## **The institutional structure is weakening in Turkey.**

In the Worldwide Governance Indicators ranking, Turkey has fallen behind in the corruption field. Meanwhile, in the Competitiveness Index by the World Economic Forum, Turkey was 75th in institutional structure, moving down 11 ranks. Following the unsuccessful coup attempt, the government firing personnel in large numbers has decreased the predictability and effectiveness of government policies.

In summary, Moody's estimates that the average growth rate of Turkey, which was 5.5% between 2010-2014, will decline to 2.7% between 2016-2019. However, Moody's added that Turkey's budget performance is good, and that the public debt ratio to GDP falling to 32.9% in 2015 is a positive development.

Finally, in its assessments Moody's mentions that the deterioration in Turkey's credit profile would last for 2-3 more years. Therefore, this indicates that Turkey's rating will not be raised in the short term.

# Medium Term Program targets were revised downwards

|                               | 2016  |       | 2017   |       |
|-------------------------------|-------|-------|--------|-------|
|                               | Old   | New   | Old    | New   |
| GDP growth                    | 4.5   | 3.2   | 5      | 4.4   |
| Per capita income (\$)        | 9,364 | 9,243 | 10,003 | 9,529 |
| Exports                       | 155.5 | 143.1 | 175.8  | 153.3 |
| Imports                       | 210.7 | 198   | 243.1  | 214   |
| CPI                           | 7.5   | 7.5   | 6      | 6.5   |
| Current account deficit       | 28.6  | 31.3  | 29.3   | 32    |
| Current Account Deficit / GDP | 3.9   | 4.3   | 3.7    | 4.2   |
| Budget Deficit / GDP          | 1.3   | 1.6   | 1      | 1.9   |
| EU defined debt / GDP (%)     | 31.7  | 32.8  | 30.5   | 31.9  |
| Unemployment                  | 10.2  | 10.5  | 9.9    | 10.2  |
| Labor Force (%)               | 51.7  | 51.8  | 52.1   | 52.3  |
| Tourism revenue               | 27    | 18.6  | 29.4   | 23.5  |

Source: Ministry of Development

- Due to major causes in 2016, with terror incidents, increasing geopolitical risks, the July 15th coup attempt, the following state of emergency, and the effects on tourism being the most significant, the Medium Term Program was revised downwards.
- In the Medium Term Program specified at the beginning of the year, growth was 4.5%, exports 155.5 billion USD, current account deficit / GDP ratio 3.9%, and the tourism revenue 27 billion USD. In the Medium Term Program revised on October 4th, 2016, the growth expectation of 2016 was decreased to 3.2%, and the growth target for 2017 was decreased to 4.4% from 5%. The exports target was decreased to 143.1 billion USD for 2016, and from 175.8 billion to 153.3 billion USD for 2017. The current account deficit / GDP ratio was raised to 4.3% for 2016, and to 4.2% from 3.7% for 2017. Tourism revenues which caused all indicators to deteriorate decreased to 18.6 billion USD for 2016, and to 23.5 billion USD from 29.4 billion USD for 2017.
- One of the most significant revisions in the Medium Term Program targets was in budget deficit / GDP numbers. The target, which was specified as 1.3% at the beginning of the year for 2016, was revised to 1.6%. And for 2017 it was raised from 1% to 1.9%. This shows that next year, public expenditure will be boosted, to support growth.

# The government accelerated reforms recently

Following the 65th government taking office on May 4th, 2015, new reform packages were announced in succession. The major objective of the reform packages is to improve the investment environment in Turkey.

**In the reform packages announced, the items below appear to be significant:**

- Exporters will be given green passports. (Approximately 15 thousand exporters)
- Suspension of bankruptcy is limited to 2 years.
- Discounts were made and uniformity ensured in stamp duty.
- An amendment was made to the law of Bank Checks to ensure that checks are honored. A QR Code and serial number was made mandatory on checks to enable easier proceedings.
- The Turquoise Card system was launched to increase the employment of qualified foreigners in Turkey.
- An amnesty for assets was launched.
- The Turkey Wealth Fund was established.

Additionally, the expansion of the current investment incentive package is on the agenda. With the new regulation, companies will be provided project based special incentives. Therefore, tax exemptions, premium support, and financing support in the current incentive system may be expanded.

# How will 2016 end?

## Growth



The third quarter will give a growth result near to zero, due to the adverse effect of tourism.



In the fourth quarter, with the effects of the announced reform packages, an approximately 3% growth is expected.



Growth will be mainly based on domestic demand in the second half of 2016, as was the case for the first half. Net exports will contribute negatively to growth.

**2.9** We expect a growth of 2.9 percent for 2016

## Foreign Trade



Exports declined in the first 3 quarters due to decreasing export prices. The last quarter will show an increase in exports, with export prices increasing.



The adverse effects of Russia and Iraq on exports continue. Although relations with Russia are on the path to improvement, there is no significant improvement in exports.



For imports, the effect of low level oil prices have ended. In the last quarter we will also see imports increasing.

### Our foreign trade expectations for 2016

- Exports **142** billion USD
- Imports **202** billion USD

## Markets



USD / TRY : **3.1**  
EUR / TRY : **3.38**  
EUR / USD : **1.09**  
Oil : **\$50**



# Conclusion

To summarize, we leave 2016 behind as a year which has been tough, both for global economy and Turkish economy. The base effect for oil and commodity prices ended in the last quarter of 2016. This means that the major cause in global trade decline has worn off. At the same time, with oil prices starting to increase recently, the shakedown in oil exporting countries' economies is coming to an end. Therefore, both global economic growth and global trade are expected to increase in 2017. In line with the optimistic expectations for the global economy, the Turkish economy is expected to show a stronger performance in 2017 compared to 2016.

For reasons such as decline in export prices ending, tourism losses recovering and the political crisis with Russia ending, Turkey is expected to grow at a faster rate in 2017, with the strong contribution of net exports. Meanwhile, we also expect that domestic demand will be stronger in 2017, with the steps taken by the government. Briefly, following a tough 2016, 2017 will be a better year for both global and Turkish economies.

# About Bakış

KPMG Bakış, a quarterly publication prepared by KPMG Turkey in both Turkish and English, provides a review of major macroeconomic indicators in the Turkish and global economies, accompanied by a brief commentary.

## Bakış 1

Turkish

English



## Bakış 2

Turkish

English



## Bakış 3

Turkish

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