Bakış

Macro Trends in Turkish and Global Economy

Issue 3

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An owl's vision and hearing capabilities are very sensitive. Rod cells in their eyes convert even the tiniest of light into a chemical signal. Therefore where a human sees just a tiny piece of light, the owl can see the object in full detail. As well as being able to catch their prey in very low light, they can also detect where it is in utter darkness and catch it using their sense of hearing. Their ears are as sensitive enough to hear the slightest crackle. With their sensitive ears, they can hear a luna moth's wing beating in a silent night, a seed being chewed, even the sound of a dropping needle in full silence.

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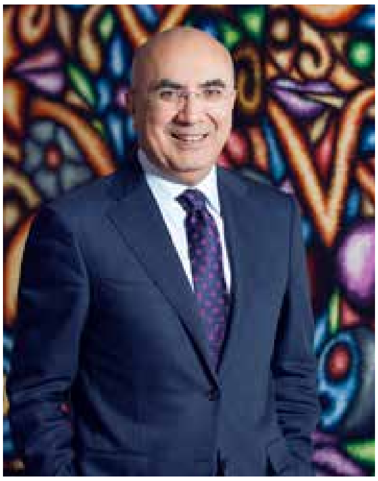
Preface



Ferruh Tunç
Chairman, KPMG Turkey
Senior Partner

The view through time and from the middle of space

Time is which is "temporal"; it is the name given to the relative relationship of now, with the past and the future.

Once upon a time, some of us would weigh the future more and some of us would give to the past more weight, but at the end, after the scalepans have swayed for some time, our time scale would reach the balance at "now", as fuller than before. Because those who were favoring the past or the future were able to bring back things which would enrich the value and meaning of today.

Whatever has happened, most those favoring the past or the future started to stay there, or to return to "now" with empty hands. Hence, "now" rapidly turned into a shallow actuality. All together, we robbed it of the inspiringness and the responsibility of the past and the future; and turned it into a hedonist, utilitarian, cunning creature inclined to "wellbeing".

Those who regard themselves as rich, knowledgeable and capable, started not to make the effort that is made occasionally by the poorest, most ignorant and the weakest of us to increase the weights in the scalepans of the past and the future, thus enriching the value of now. From their vantage point, we have been outside of time for a long time. We are puzzled, as if we are watching ourselves and our lives from outside, from a time machine.

*

Space, is first the universe, then the world; but it is the country at most, in the sense of a place where a flower blossoms; we connect to the world and the universe through it. Once upon a time we had a mutual passion, which we have called "to make our country more beautiful". But somehow, each of us was taken away with only their own understanding of beautiful, and what is worse, that there is only one "beautiful". By speaking ill of other people's "beauty", we lost the sense of beauty in ourselves. Gradually, our passion to bring our country to a more beautiful state was turned into our obsession to carry it somewhere else no matter what, and we damaged our roots. We were blinded to the beauty and the value living in it. We failed to say the poem of the flower blossoming at a cliff ("My homeland you cliff!"[1]) for our homeland, that is much more than a cliff. Though we are here, it has been as if we are not the locals of this space.

*

Then, we can say that the biggest action awaiting us is to reinvent our place in time and space, collectively (re-orientation): If, recently, it is as if everything happens to us and at once, this proves that we are outside of time and lost in space. Now we can accept that and start doubting our understandings which have brought us here, and remember what we have forgotten.

More or less, to whatever extent we do this, what is of priority is that we think independently, and outside the box. If we can melt data in information, turn information to insight and realize insight in ourselves, we may never be timeless and spaceless again, we can rediscover the "we", moreover, we can see the meaningful life beyond "wellbeing", and reestablish that.

*

We have written the preface of the third issue of Bakış which includes macroeconomic data and comments on Turkey and the globe, with the feelings of having just escaped the verge of a cliff, but with the inspiration of a flower blossoming at the cliff.

With responsibility, with hope, we wish you a good read.

[1]Cemal Süreya, "Uçurumda Açan"

General Outlook

2016 continues to be an extremely busy year for the world, both politically and economically.

No doubt the most important issue facing the global economy in recent months has been the United Kingdom's decision to exit the EU. This exit will have effects not only on the EU economy, but on the global economy as well. Turkey is one of the economies that will feel the effects of Brexit. What we can basically say on this issue is that the exit will adversely affect Turkey's exports to EU and the UK, and positively affect exports to the rest of the world. The EU economy continues to perform weakly compared to the US and this will be the same in the coming period. Despite the fact that the US data is looking good, a comprehensive FED interest rate increase is not likely in a short period.

The Turkish economy continues a strong and dynamic performance, despite the fact that, in terms of the nature and the volume, the maximum of problems a country can face under normal conditions have occurred. If the events of July 15 had occurred in a country other than Turkey, the people would not have responded as such and worse results would have occurred. All economic and commercial data continue to perform with the least damage possible.

The reforms announced by the government in the past three months meet most of the long-awaited expectations for change in the economy. In this period, while investment, production and exports will be supported, the change in the private pension system has been a big step towards increasing national savings. This creates an important support for the current account deficit in the long term. Now is the time to implement the reforms and encourage investment appetite.

Global

Who would have guessed that we would be facing such developments in 2016?

The election race in the US sometimes reminds one of a Middle-Eastern country. Europe faced arguments and recriminations due to the Brexit, which we still haven't got used to. The UK announced a new monetary expansion. Turkey's relationship with Russia attracted the attention of all major players, from the US to China. Terrorist attacks increase rapidly throughout the world.

Hence we see that the eight years of weak recovery for the world economy following the global crisis have been accompanied by tensions in non-economic areas.

In 2016, with the effect of a strong US dollar, oil and commodity prices are still below of last year.

A weak growth in global trade and investments, low levels in wages and the stalling performance of emerging countries are the factors restricting growth in 2016.

The decline in global trade continues in 2016. In the first half of the year, global trade dropped by approximately 5%.

Oil prices are still at lower levels compared to 2015. By the end of summer, the base effect in oil prices will come to an end. As Turkey, we are looking ahead to days when the decline in the current account deficit will slow down.

The Chinese economy performed its worst in the last 25 years with a growth rate of 6.9% in 2015. This year's growth expectation is 6.5%. One significant reason behind the slowdown in global growth and trade is this situation of China.

Among the big economies, the best data is still coming from the US, but this should not be interpreted as an impending interest rate increase. While interest rates are low and markets are weak for all players, the US will not want to increase the interest rate gap, and even if they do, we think they will delay this as much as possible.

Global growth expectations decline in 2016

- Throughout the eight years following the global crisis the world economy's recovery has been weak.
- In 2015, a strong US dollar, coupled with low oil and commodity prices, negatively affected emerging economies. Brazil and Russia especially are among the most affected countries.
- In 2016, with the effect of a strong US dollar, oil and commodity prices are still below of last year.
- A weak growth in global trade and investments, low levels in wages and the stalling performance of emerging countries are the factors restricting growth in 2016.

Growth %

IMF	3.4	3.2
OECD	3.3	3.0
World Bank	2.9	3.0

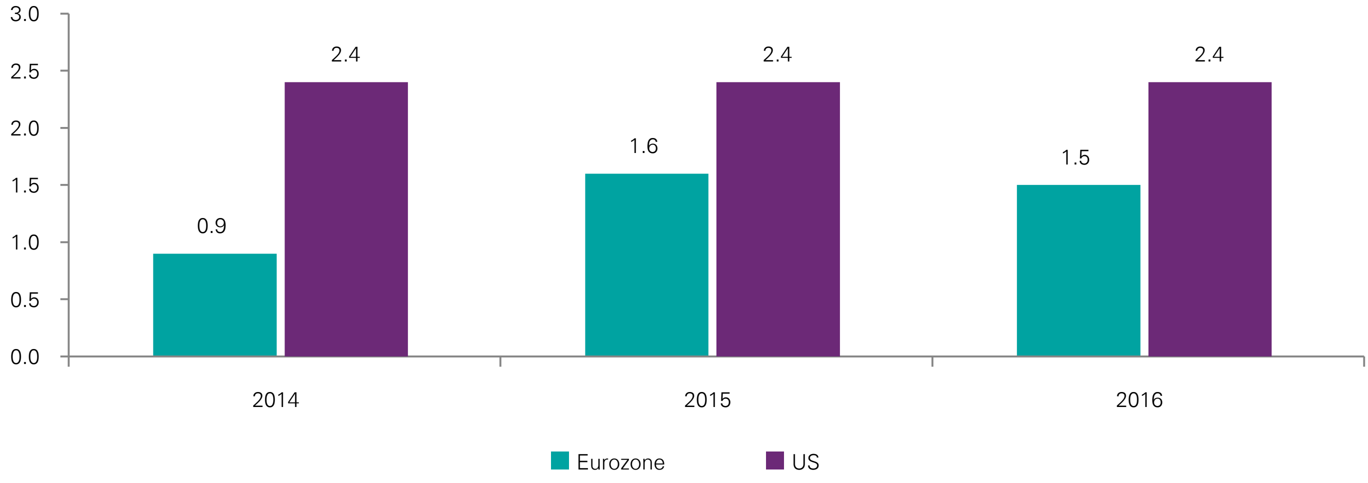
Source: IMF World Economic Outlook

EU shocked by the Brexit decision... USA postpones interest rate increases

The eurozone adopted a policy of monetary expansion, aiming to contribute to economic recovery in the eurozone and in the EU (28) in general. Most recently, Draghi, the President of the European Central Bank, expanded the asset purchase program to 80 billion euros from 60 billion euros, and lowered the policy interest rate to 0%. However, the effectiveness of monetary policy in the EU is about to end. While Europe's economy was struggling with its own problems, an additional shock came with the Brexit decision. As a result of the referendum in June, the United Kingdom decided to leave the EU. With this result, growth forecasts in the EU and eurozone will decline more in the coming period.

In the US, employment data announced in the beginning of August gave strength to the perception of an interest rate increase, but the market does not seem to believe this will be realized in the rest of the year.

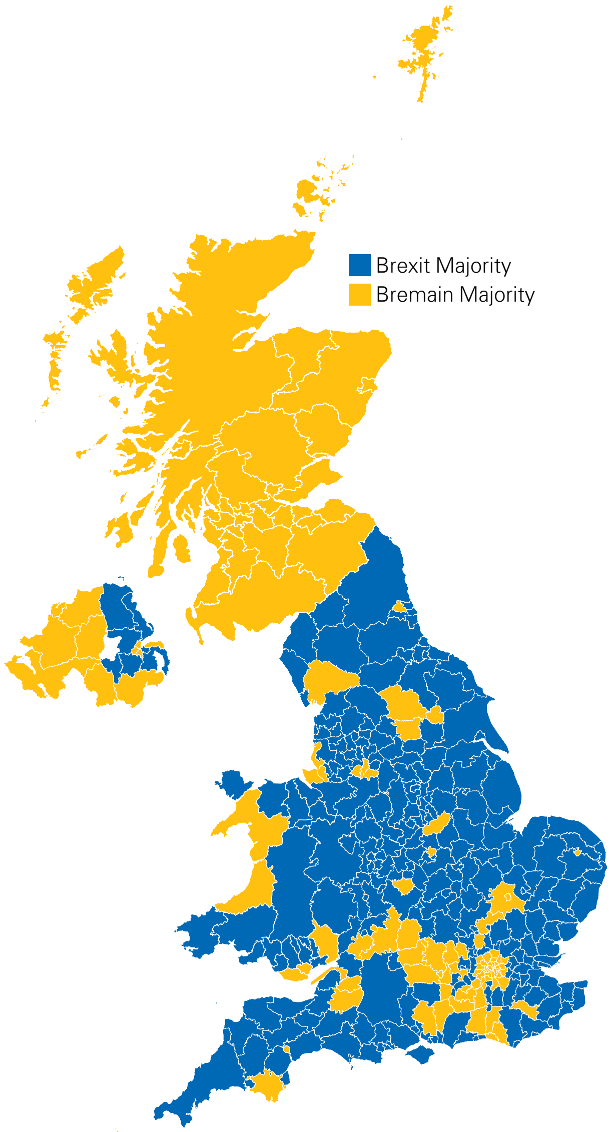
Growth %



Source: IMF World Economic Outlook

Brexit to change the balance in Europe

- The political impact of Brexit is discussed more than its economic impact. In the referendum held in September 2014, Scotland chose to stay in the United Kingdom with a 55% of the vote. In the Brexit vote, 62% of Scotland voted to stay in the EU. With this result, it is said that Scotland may hold a referendum again to leave the United Kingdom. Similar voices are being heard in Northern Ireland, too.
- The effects of Brexit on the UK being as such, opposing voices have started to increase in the EU as well. In polls within the EU, it is seen that EU exit supporters are increasing in countries such as Italy and France.
- Therefore, whether Brexit will create a domino effect or not is an unanswered question.



Brexit to change the balance in Europe

- Following the Brexit decision, Europe and world exchanges have fallen. The sterling has decreased to its lowest point against the US dollar since 1985. How commercial relationships will be formed after the UK leaves the EU is of great interest.
- Following Brexit, the EU and the UK will negotiate exit models. These negotiations are estimated to last for two years. Until the negotiations conclude, relationships will continue as if the UK is in the EU.

Possible exit models are expected to be as follows:

Turkish model: Being in the Customs Union with the EU

Norwegian model: Being in the European Economic Zone

Swiss model: Entering into dual agreements without being in the European Economic Zone

WTO model: Trusting the World Trade Organization rules to access the European market

Special model for the UK: Building an agreement between the EU and the UK to specify rules only for the UK.

Effects of Brexit on Turkey

- **Within the period until the UK leaves the EU, no change is expected in mutual trade relationships. Once the exit takes place, trade relationships may vary according to the possible models.** If the UK continues to stay in the Customs Union after leaving the EU, a change in mutual trade relationships with the UK is not anticipated.
- If the UK does not stay in the Customs Union and signs a comprehensive Free Trade Agreement (FTA) with the EU, to avoid our trade relationships being diminished, (according to the current situation) Turkey must also sign the FTA with the UK. In this process, if the update on the Customs Union between Turkey and the EU is completed, again trade relationships are not expected to change because Turkey will be a direct party to the FTA between the EU and the UK.
- If the UK leaves the Customs Union and does not sign an FTA with the EU, trade relationships would decline because the customs wall between Turkey and the UK would become significant.
- On the other hand, in addition to all scenarios, GDP decline in the UK due to leaving the EU would decrease the UK's purchasing power and this would affect our exports to this country adversely.

Murat Palaoğlu
KPMG Turkey
Brexit Turkey Leader

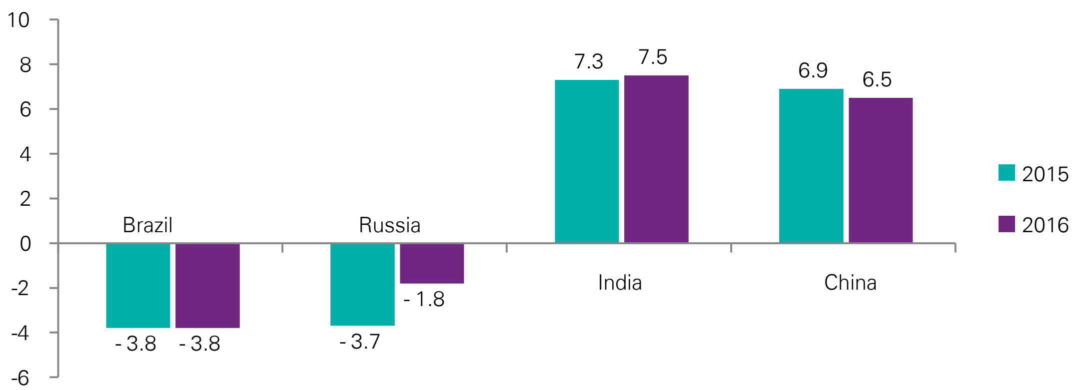
When positioning against the potential effects of Brexit on Turkey, it is a fact that the global reasons and consequences of these effects should be clearly understood and integrated strategies should be set.

Anticipating this fact, KPMG founded a UK-based "Brexit Centre of Excellence". With this centre, KPMG is assisting the business world on how the short-term risks and opportunities such as competitive advantage should be read, as well as giving necessary messages and explaining the correct position to the society and decision-makers.

Beyond a simple risk-opportunity analysis, the need to reconsider strategy decisions such as M&A or IPO is also becoming clear. For this purpose, KPMG Brexit Centre of Excellence integratedly collaborates with KPMG in Turkey.

As 2015, 2016 is anticipated to be a difficult year for emerging economies.

The weak performance of emerging economies is expected to continue in 2016.



Among the BRIC countries, India is the country with the best economic performance. With its 7.9% growth rate in the first quarter, things are going well in India. By the end of the year, India is expected to grow by 7.5%.

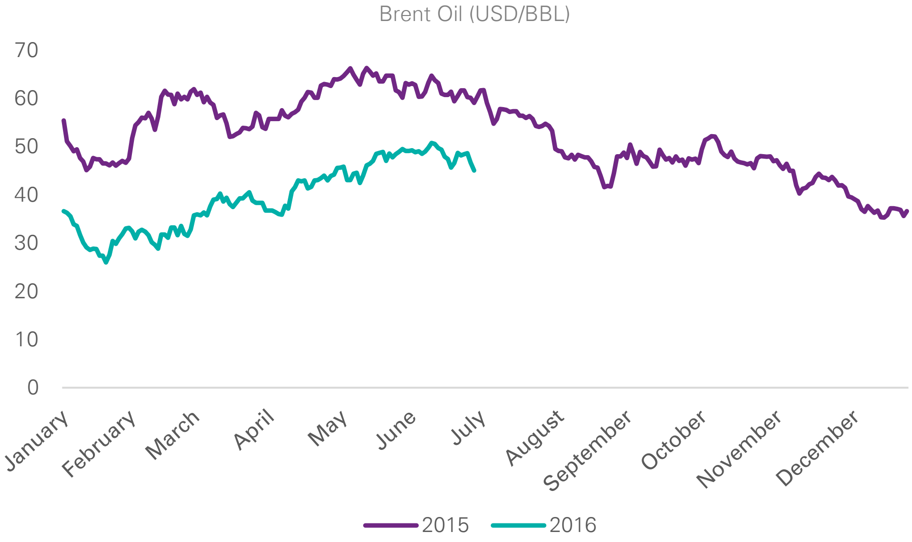
Brazil For Brazil, the biggest problems are low level commodity prices and government debt at historically high levels. The Brazilian economy shrank by 5.4% in the first quarter and is anticipated to decrease by 3.8% by the end of year.

Russian economy collapsed in 2015 due to the decline in oil prices. In 2016, oil prices still at low levels continue to affect Russia. The Russian economy is expected to see a shrinkage of 1.8% this year. In the first quarter, GDP fell by 1.2% in Russia.

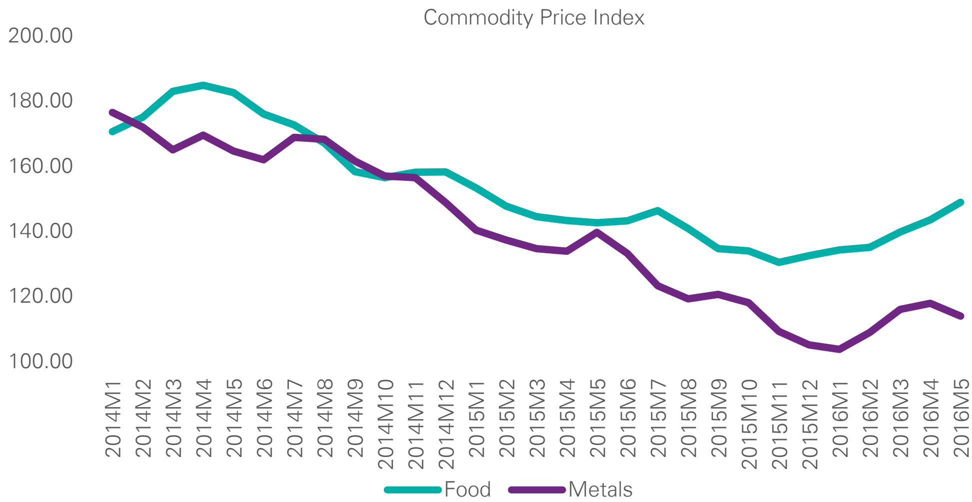
The Chinese economy performed as its lowest in 25 years with a growth rate of 6.9% in 2015. This year, growth is anticipated to be 6.5%, even lower than the previous year. In the first quarter, China grew by 6.7%.

Source: IMF World Economic Outlook

Oil and commodity prices are recovering.

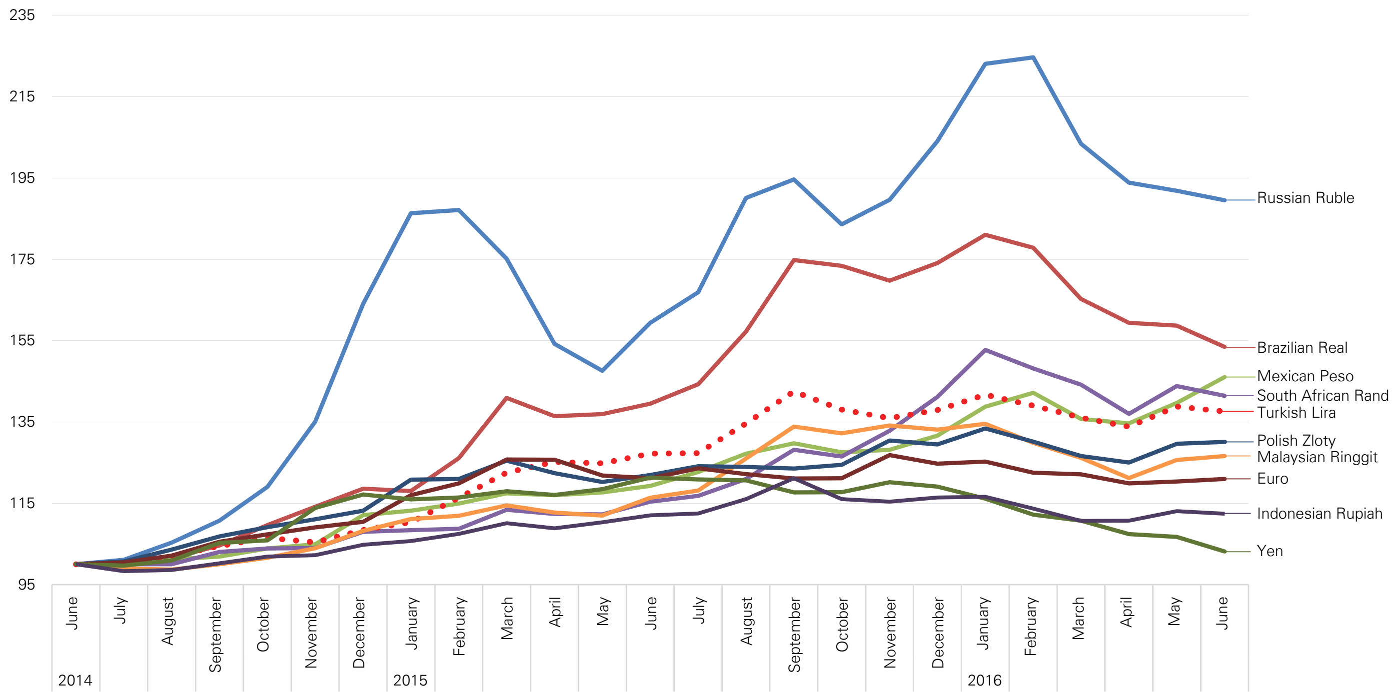


Since the beginning of 2016, oil prices have been experiencing an increasing trend. Factors affecting this increase are the US dollar having declined moderately and oil supply decreasing throughout the world. But still, oil prices are at lower levels compared to 2015. By the end of summer, it is expected that the base effect in oil prices will come to an end.



Commodity prices move in parallel to oil prices. Global food prices have started to recover since the end of 2015 and metal prices are going up as of the beginning of 2016. However, commodity prices, just like oil prices, are below those of 2015.

Development of other exchange rates against USD



The US Dollar, which appreciated beginning with the second half of 2014, started to depreciate in 2016, with the expected interest rate increases not being realized. The US dollar index has decreased by 3% since the beginning of the year up until now, and many currencies including the Russian rouble and Brazilian real recovered their losses. Yet since 2014 the US dollar has still been close to 100% more valuable than the rouble, and more than 50% than the real. This rate is approximately 36% for TRY. Among these currencies, TRY is the fifth most depreciating currency against the US Dollar. Another considerable issue in the last period is the Japanese yen's appreciation against the US Dollar. Towards the middle of 2015, the yen depreciated over 20% against the US dollar, but later recovered and dropped this rate down to 3%.

Low levels in oil and commodity prices cause global trade to decline

- In 2015, global foreign trade was at approximately 16.5 trillion US dollars. That is to say, growth recorded in trade since 2010 seems to be evaporating. This finding, of course, applies if trade is measured in USD terms. The increase continues in terms of volume.
- Decline in world trade continues in 2016, too. In the first five months, global trade fell by 5.4%.
- Looking in country base, in the first five months, US exports declined by 6.9%, while imports declined by 5.4%.
- In the same period, EU exports and imports decreased by 0.5%, Russian exports decreased by 31.2% and imports by 11.2%.
- According to the data of the first 6 months, Chinese exports decreased by 6.5% and imports by 10%.

Declines in 2016 global trade

	Exports	Imports
	-5.4%	
	-6.9%	-5.4%
	-6.5%	-10%
	-0.5%	-0.5%
	-31.2%	-11.2%

Turkey

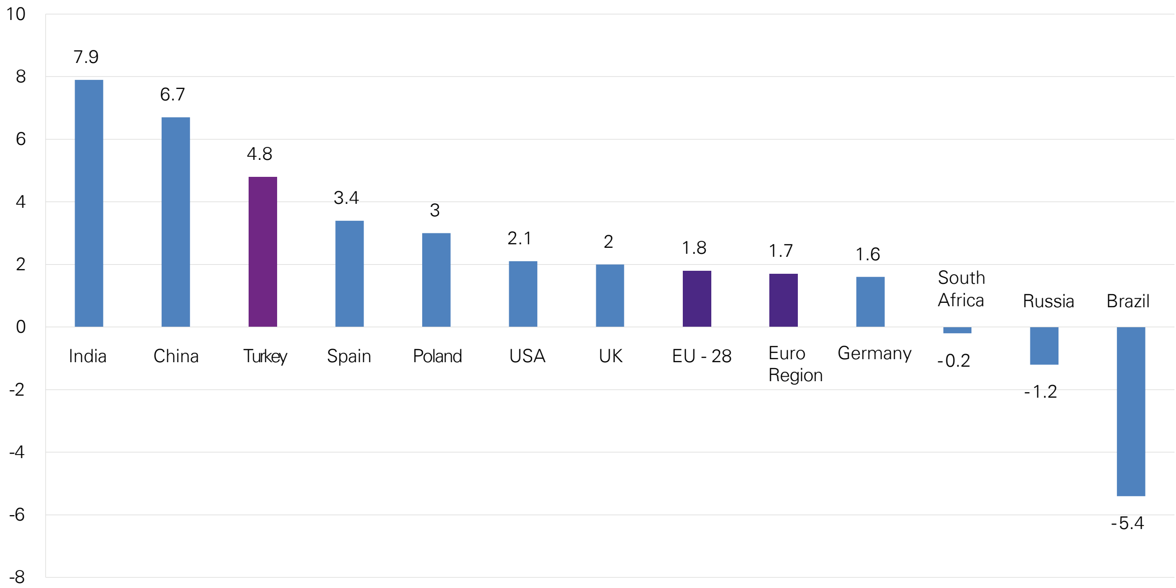
In the last period we have seen some positive movements in growth. The growth of 5.7% seen in the last quarter of 2015 is the highest figure reached since 2011. 4.8% growth in the first quarter of 2016 is again a successful figure for Turkey. However, due to losses in tourism, we anticipate growth to be lower than this level for the rest of the year.

In April and May, industrial production was recorded at an average of 3.8%. In this period, taking the losses in tourism into account, a 2.5% growth is expected for the second quarter. In the third quarter, the effect of tourism on GDP is higher, compared to other quarters. Growth may slow down further. But recovery may occur in the last quarter and especially in 2017.

Current account deficit continues to decline in 2016. The biggest factor affecting the decline in the current account deficit is the decline in energy imports, due to falling oil prices. We anticipate that the current account deficit will continue to fall until July and then start to increase.

In 2016, the number of tourists travelling to Turkey dropped severely. The number of tourists travelling to Turkey was 10.7 million between January-June 2016, decreasing by 27.9% year-on-year. This means a decrease of approximately 4.2 million in the number of tourists. As for our biggest competitors in tourism, in the same period tourists travelling to Spain increased by 11.4% and to Greece by 5%.

Growth: We are the 5th fastest growing country in the first quarter



In the first quarter of 2016;

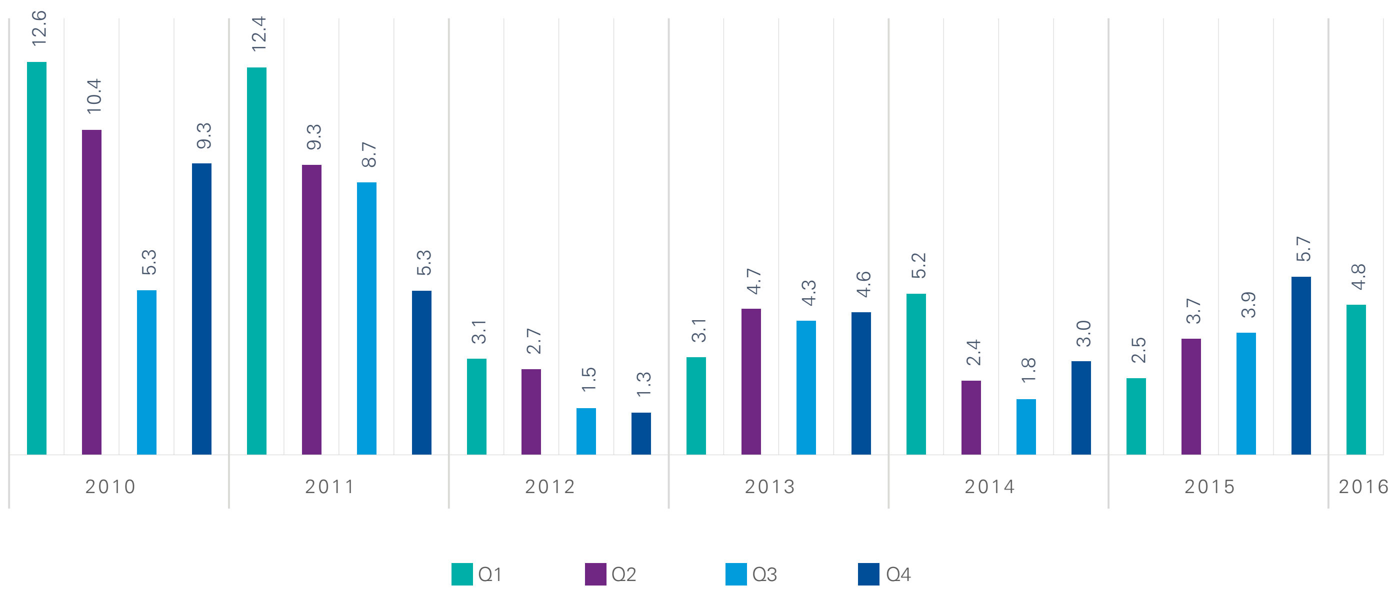
- India came first in growth
- Turkey performed better than all EU countries that have announced their data
- Turkey was the 5th fastest growing country following India, the Philippines, China and Indonesia.
- The US went above 2% in growth
- EU showed a limited recovery
- Russia and Brazil continued to downsize due to low oil and commodity prices

Growth continues, despite international problems

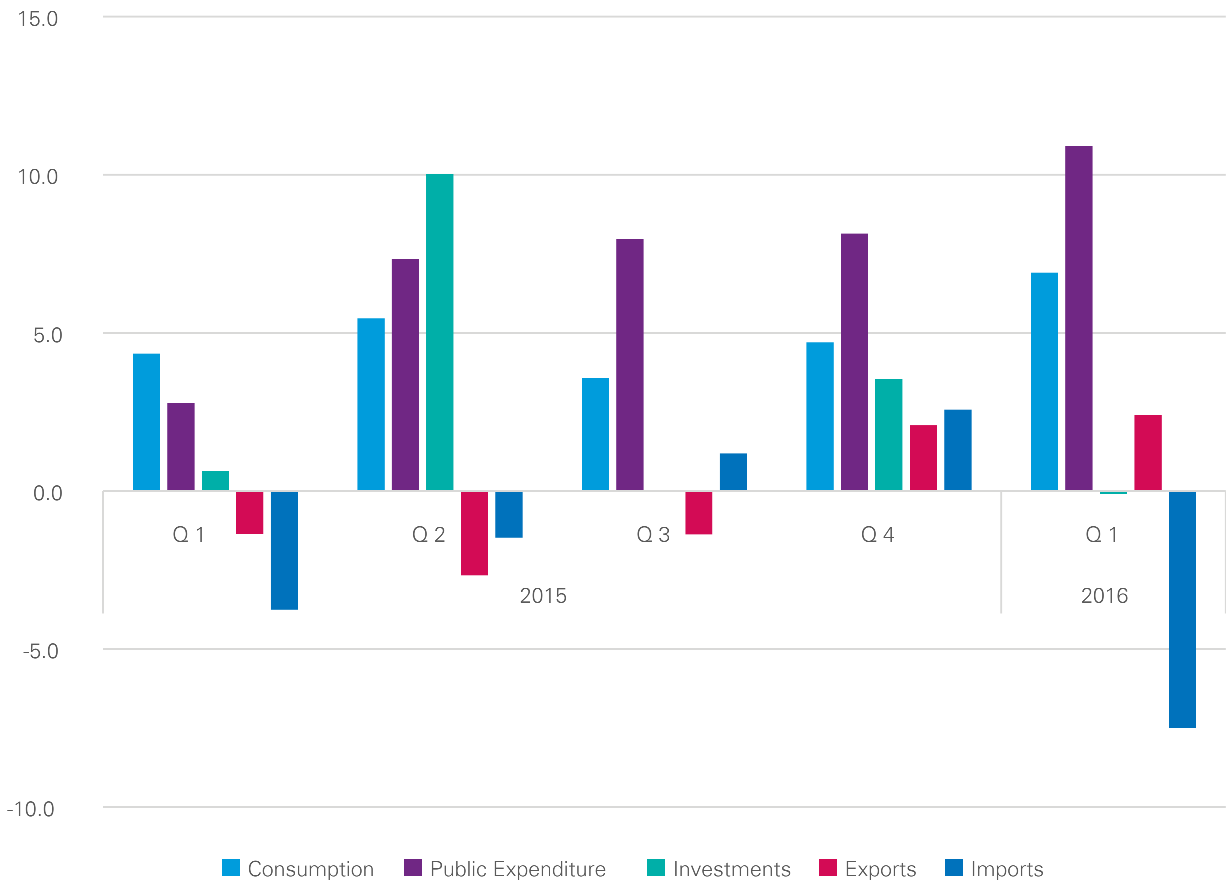
Since 2012, growth in Turkey has been at an average of 3.4%. These levels are below Turkey's potential. In the last period we have seen some growth. The growth of 5.7% seen in the last quarter of 2015 is the highest figure reached since 2011. 4.8% growth in the first quarter of 2016 is again a successful figure for Turkey. However, due to losses in tourism, we anticipate growth to be lower than this level for the rest of the year.

In April and May, industrial production was recorded at an average of 3.8%. In this period, taking the losses in tourism into account, 3% growth is expected for the second quarter. In the third quarter, the effect of tourism on GDP is higher, compared to other quarters. In the light of the latest developments in the country, we expect more losses in tourism, and downsizing in the third quarter. And in the fourth quarter we expect a recovery and a growth rate around 3%

Turkey 2010-2016 growth rates

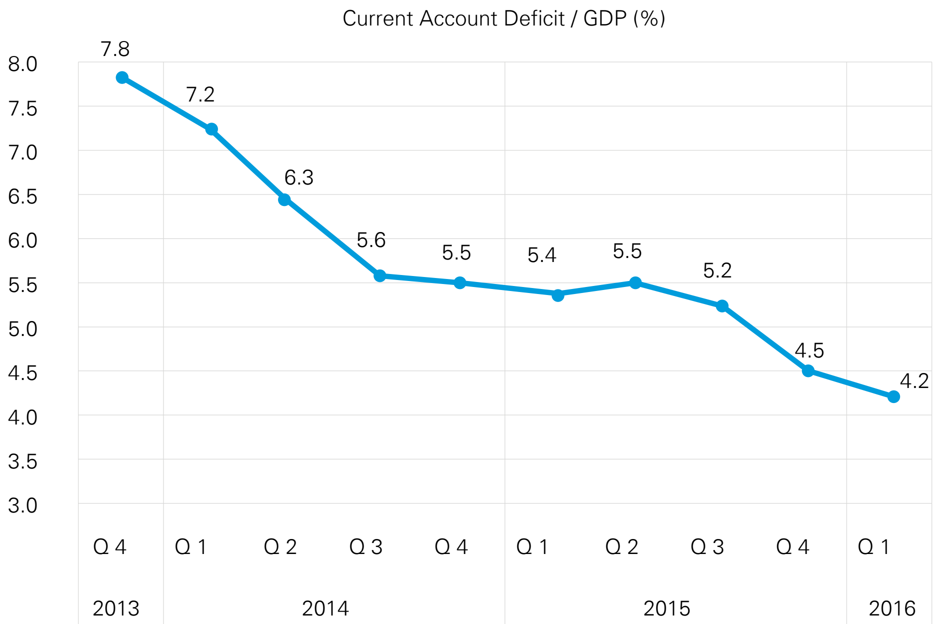


Investment contribution to growth must increase



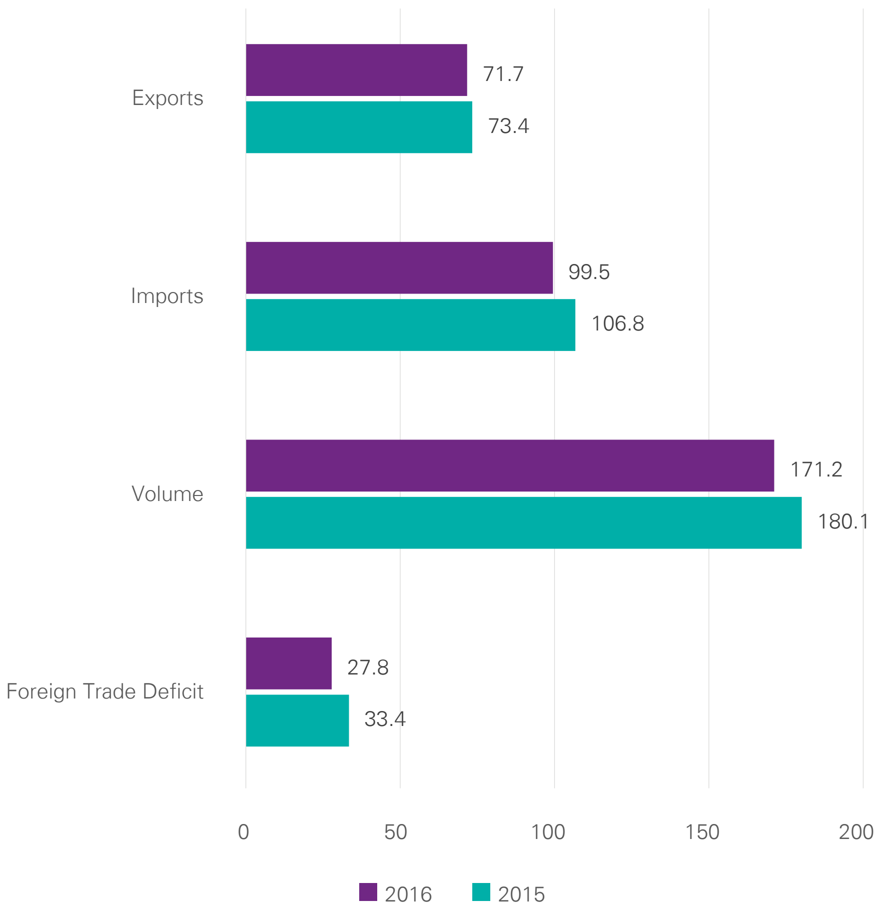
- In 2016, again, growth is moving with the contribution of domestic demand.
- In the first quarter, the contribution of domestic demand to growth was 5.9 points, while net exports' contribution was negatively 1.54 points.
- **In 2016, strong domestic demand moves real imports upwards, while export increase is limited, due to problems in neighboring countries. Considering the losses in tourism, in 2016 we anticipate net exports to negatively contribute to growth.**
- In 2016, the main driver of growth has been consumption and the stagnation in investments has continued.
- We can expect that the package announced before Eid al-Fitr will have positive effects for 2017.

Current account deficit decreased to 4.2 percent in the first quarter



- The current account deficit declined in 2015 by **26.3% compared to last year, from 43.6 billion USD to 32.1 billion USD.**
- The current account deficit continues to decline in 2016. The biggest factor affecting the decline in the current account deficit is the decline in energy imports, due to falling oil prices. The decline in current account deficit has ended. We can see a gradual increase in the coming months.
- In June 2016 the foreign trade deficit increased for the first time. By the end of summer, it is expected that the base effect in oil prices will come to an end. Therefore, the decline in foreign trade deficit due to oil will come to an end. Additionally, losses in the tourism sector are expected to move the current account deficit upwards in summer.
- By the end of 2015, current account deficit declined to 4.5%, while the ratio to GDP declined to 4.2% in the first quarter of 2016. With the positive movement in current account deficit reversing, it is expected that we will increase to the levels of 4.5% again.

Exports are decreasing in dollars - increasing in volume



*Values are in billion USD.

- In the first half of 2016, exports decreased to 71.7 billion USD, decreasing by 2.2%. Exports by volume reached 52.6 million tons, increasing by 6.5%.
- Imports decreased more than exports by 6.8%, to 99.5 billion USD.
- In this period, the foreign trade deficit decreased by 16.8%, to 27.8 billion USD.
- In the first half of the year energy imports decreased by 37.2%, to 13 billion USD. And this means a 7.7 billion USD fall. Imports excluding energy increased by 0.5%.
- In the decline of exports in the first half of 2016, the drop in gold exports was an important factor. In this period gold exports decreased by 11% and exports excluding gold decreased by 1.2%.
- For exports, problems in Russia and other neighboring countries, exchange rates and raw material prices have proved important disadvantages, but volume based increases in exports to EU and other markets compensated for these losses.

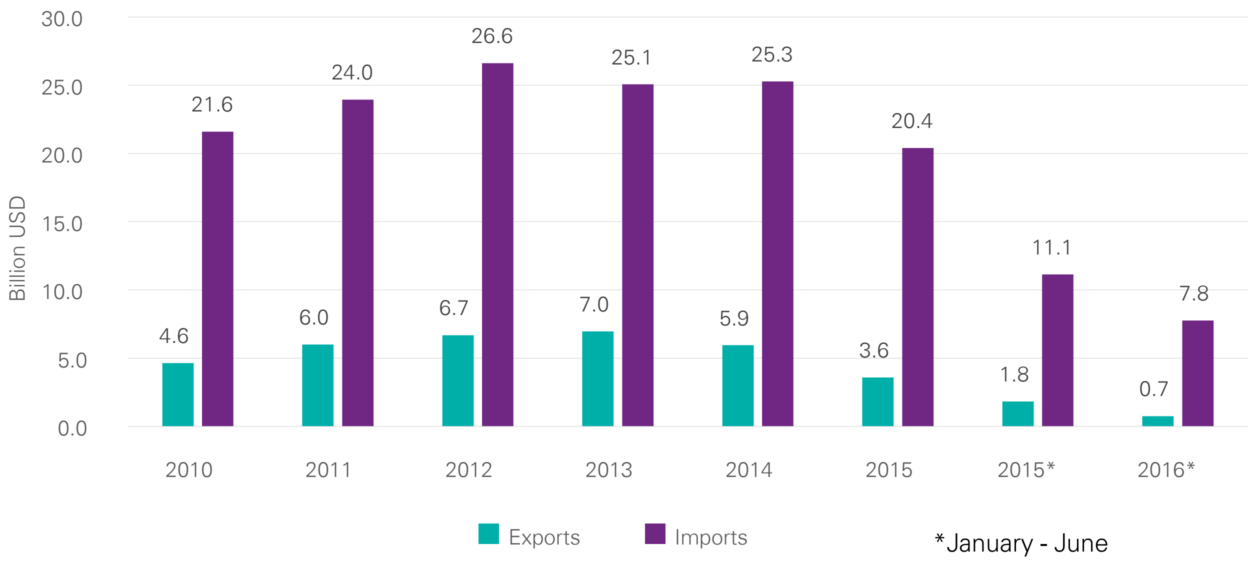
Export of goods - Countries

Million USD	2015	2016	Change (%)
Germany	6 494	6 986	7.6
UK	5 369	5 977	11.3
Iraq	4 460	3 520	-21.1
Switzerland	4 075	1 915	-53
Italy	3 327	3 723	11.9
USA	3 106	3 283	5.7
France	2 845	3 016	6
UAE	2 838	1 898	-33.1
Spain	2 301	2 499	8.6
Saudi Arabia	1 895	1 725	-9
Iran	1 893	2 426	28.2
Russia	1 833	745	-59.4
Egypt	1 486	1 403	-5.6
Israel	1 369	1 509	10.2
Libya	818	468	-42.8
Syria	739	625	-15.5
Ukraine	509	586	15.1

Source: TÜİK (Turkish Statistics Institute)

- In the first half of 2016, increases in exports to EU countries were significant. In this period, exports to EU countries increased by 8.6%, compared to the same period last year.
- Among EU countries, our exports to Italy increased by 11.9%, to Germany by 7.6%, to France by 6%, to Spain by 8.6%.
- Exports to the CIS and Middle-Eastern countries decreased by 23.5% and 5.8% respectively.
- Among factors of the decline in exports to these groups of countries, export losses to Russia and Iraq are the major ones. Turkey's problems with Russia and the worsening Russian economy caused exports to this country to drop by 59.4% in the first half of the year. Armed conflict in Iraq causes exports to this country to decrease. In the first half, our exports to Iraq decreased by 21.1%.

Normalization process with Russia begins

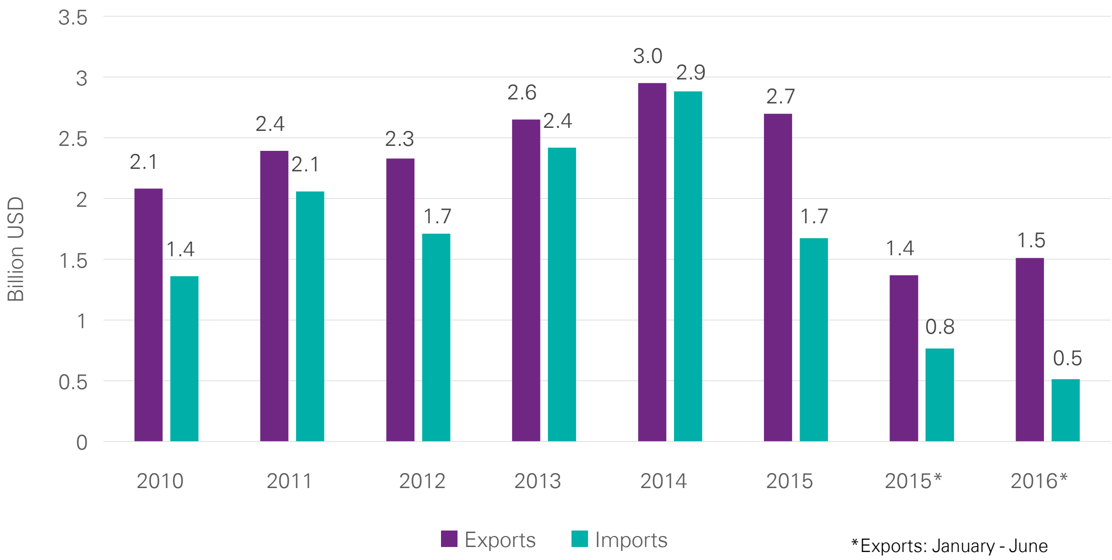


*January - June

- Mutual trade with Russia experienced an increasing trend until 2014. However, in 2014 oil prices started to decrease and the devaluation of the rouble by nearly 100% caused severe damages to Russia's purchasing power. In 2013, exports to Russia reached the highest level so far at 7 billion USD and started to decrease continuously since then. Lately, in 2015, with exports of 3.6 billion USD, we went below 2007's export levels.
- Similarly, with oil prices decreasing, our imports from Russia also declined severely.
- And in 2016, in addition to the problems in the Russian economy, the political crisis between the two countries hurt foreign trade seriously. In the first half of 2016, exports to Russia shrank by 59%, whereas imports from Russia declined by 30%.
- With the relationship now improving, export loss to Russia is expected to revert back to the 35% levels by the end of year.

Our foreign trade with Israel

- It is observed that since 2010, when a political crisis occurred between Turkey and Israel, foreign trade has not been affected by political developments. Since 2010, our exports to Israel have been increasing every year, with only a decline due to a price effect in 2015. And in the first half of 2016, exports to Israel increased by 10.2%. With the relations with Israel going better, this increase trend in exports is expected to move upwards.
- A similar trend is observed in imports from Israel. Imports, which increased until 2015, dropped severely in 2015 down to 1.7 billion USD. However, on the contrary to exports, there is a 33% decline in imports in the first 5 months.



*Exports: January - June
*Imports: January - May

Number of tourists decreased by 2.5 million in the first five months

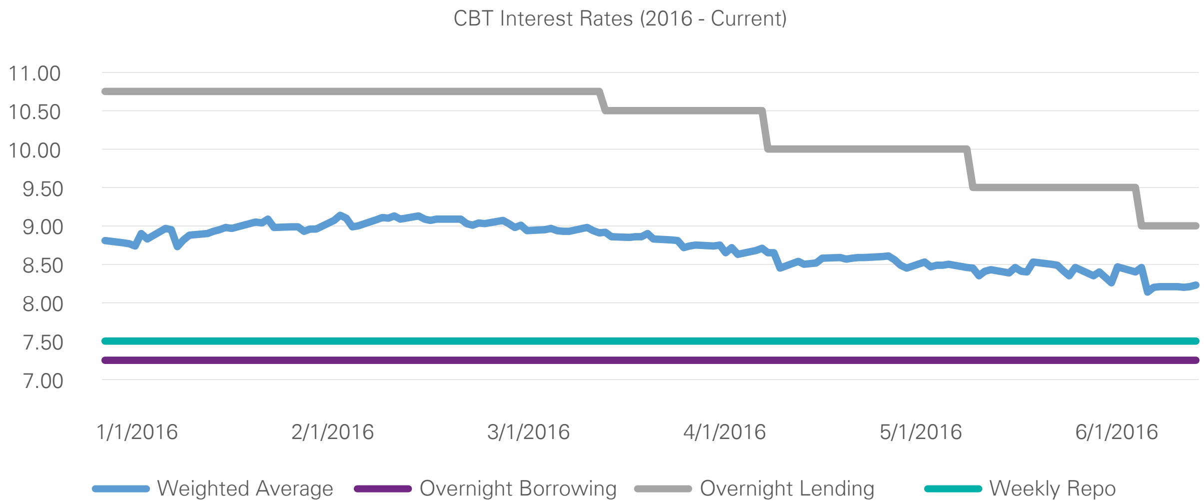
Tourist Number Loss (%)	
Russia	82.8
Libya	73.5
Thailand	59.9
Australia	58
Iraq	55.9

Country	Thousand Persons	Change (%)
Germany	1.157	-25.5
Georgia	844	26.8
Iran	693	5.7
Bulgaria	647	-2.8
UK	459	-22.4

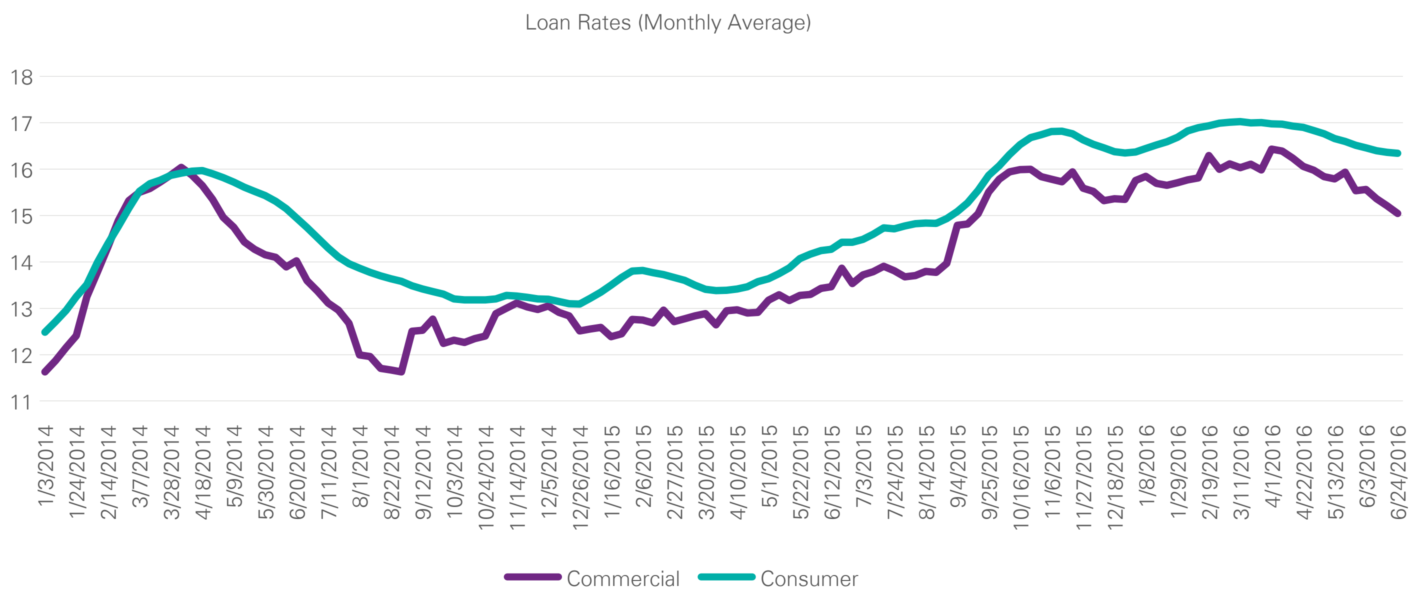
- In 2016, the number of tourists travelling to Turkey dropped severely. The number of tourists travelling to Turkey was 8.3 million between January-May 2016, decreasing by 22.9% year-on-year. This means a decrease of approximately 2.5 million tourists. As for our biggest competitors in tourism, tourists travelling to Spain increased by 11.4% and to Greece by 5% in the same period.
- In the first 5 months of the year we have experienced the biggest loss in the number of tourists from Russia, with 82.8%. Libya, Thailand, Australia and Iraq followed Russia. In this period, for our top 5 visiting countries, there have been decreases from Germany, Bulgaria and the UK, and increases from Georgia and Iran.
- Tourism revenues decreased by 19.7% in the first 4 months of 2016, compared to the previous year.
- The normalization process with Russia will not compensate for the losses of the first half of the year, but the performance will get better relatively in the remaining 6 months. We anticipate tourism revenues to drop to 21 billion USD in 2016, which was 26.6 billion USD in 2015.

Interest rates in Turkey after FED's announcement

- Since March, CBT has been decreasing the upper band of the interest rate corridor. As its latest action, in July the upper band was decreased by 25 basis points, down to 8.75%.
- Weighted funding cost was at 8.9% levels when CBT started these cuts, now it decreased to 8% levels.
- The attempted coup on July 15 caused a limited and short-time increase in market interest rates. This effect decreased more in the following three weeks.

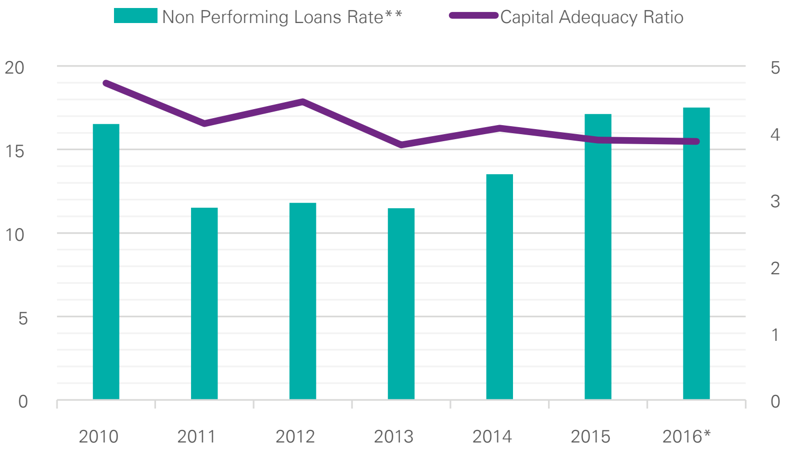


Loan interest rates are still high



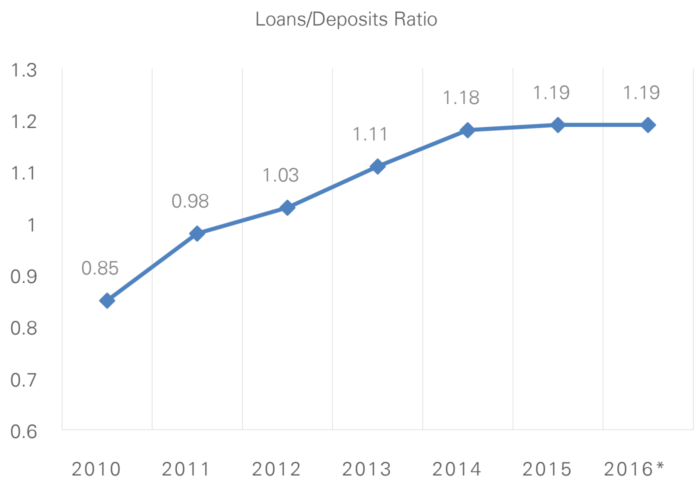
- In the last period CBT is making cuts in the upper band and weighted funding cost is decreasing. However, loan interest rates are still at high levels.
- At the beginning of 2014, when CBT increased the policy rate to 10%, the average interest rate of the banks for consumer and commercial loans increased to levels of 16%, but went through a decline trend afterwards, reaching levels of 12-14%.
- Now, despite the policy interest rate being 7.5%, the average interest rates of consumer loans are still at the high levels of 2014. For commercial loans, interest rates were only able to decrease to 15% levels from 16%, following interest rate cuts since the beginning of March.

Banking indicators do not look great



*Data by the end of March

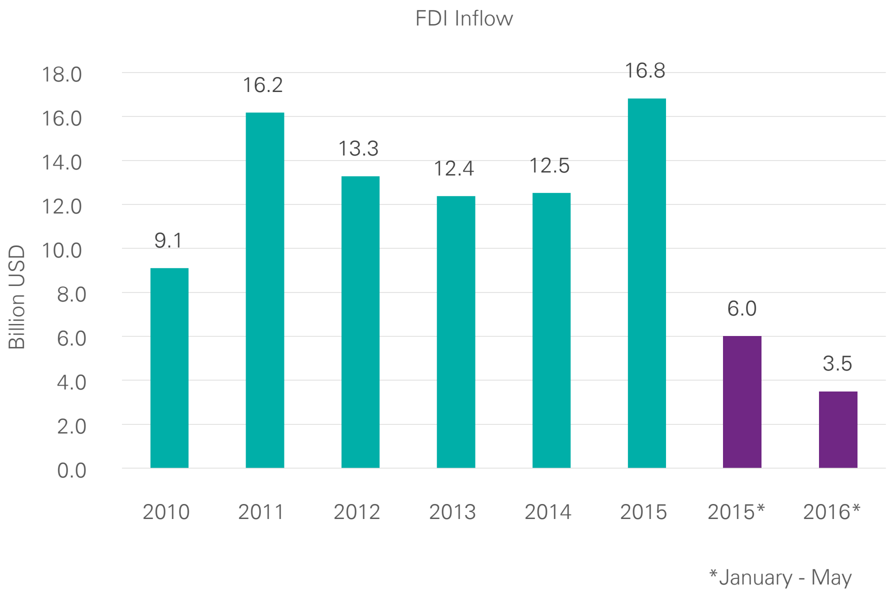
**Right axis (Consumer loans)

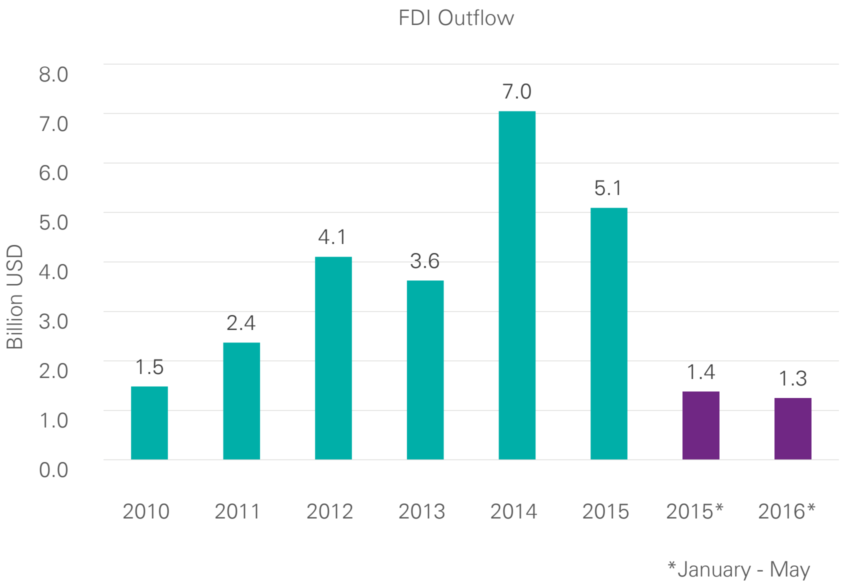


*Data by the end of March

- Since the second half of 2014, with the dollar appreciating across the entire world, the USD/TRY exchange rate has increased from 2.1 levels to 3 levels. As the result of such an high increase, the numbers of private sector which has dollar denominated debt, and of the banking sector, have deteriorated.
- Non-performing consumer loans rate reached 4.38% levels as of March 2016. This rate had increased to 6% in 2009. If this rate approaches the levels of 6% in 2016, the banking industry may face problems. Moreover, the capital adequacy ratio of the banking industry is at lower levels compared to previous periods. This ratio must be at a minimum level of 8% according to Basel criteria. Therefore, the current ratio is far above this level but the ongoing decline creates a risk.
- Another problematic indicator is the ratio of loans to deposits. As of March 2016, this ratio is at 1.19% level. That means, banks extend more loans than the deposits they collect. This signals that cross-border debts of banks have been increasing.

FDI (inbound and outbound)



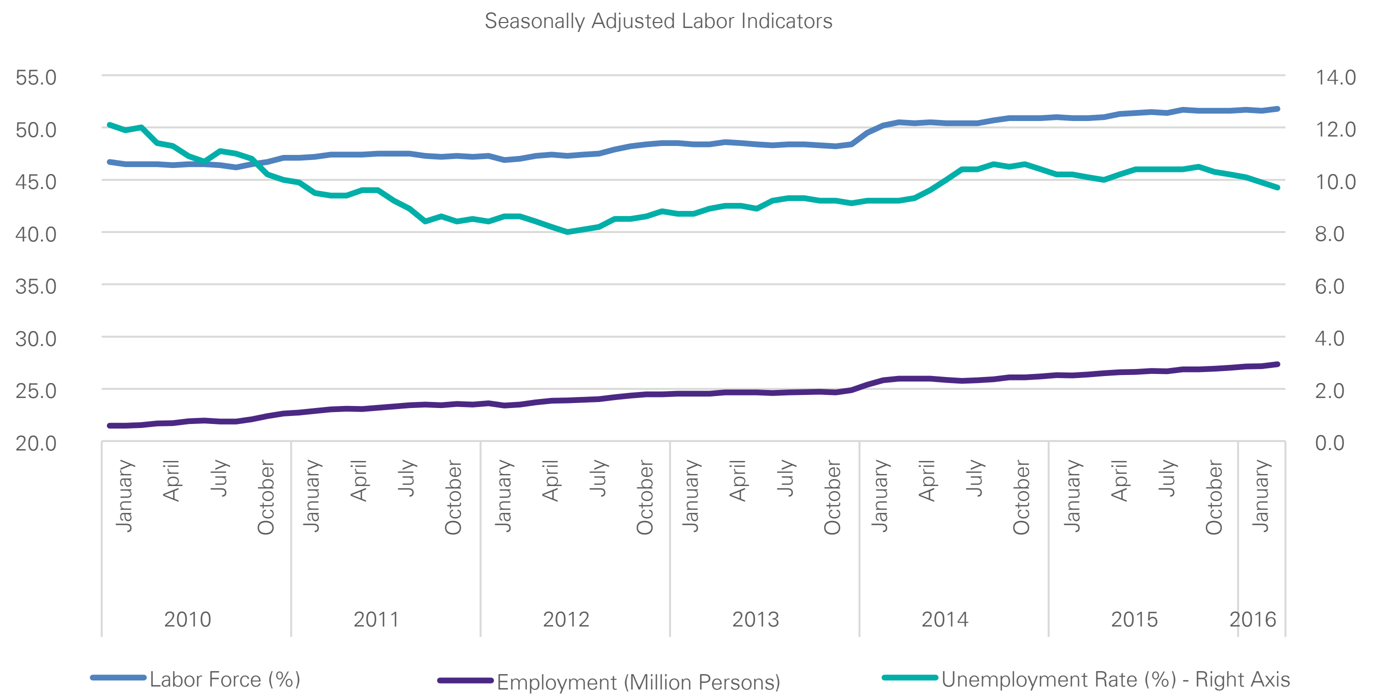


Foreign direct investment to Turkey reached its highest level following the global crisis in 2015, with 16.8 billion USD. Investments to Turkey in 2015 increased by 34%, compared to 2014. In the world, global direct investments increased by 36%. Company mergers and acquisitions were a factor in this increase in global investments. Greenfield investments only increased by 9 per mille in the last year.

According to UNCTAD report, it is expected that company acquisitions, which increased by 61% in 2015, will not be observed in 2016, and global investments will decrease. In Turkey, foreign direct inbound investment has decreased by 41.7% in the first 5 months.

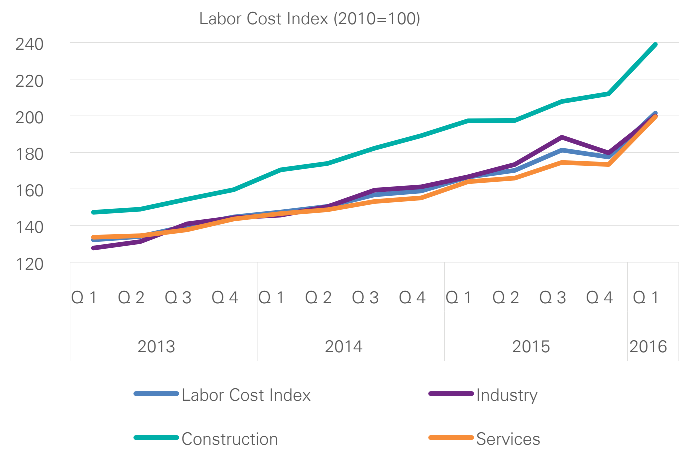
Outbound investments from Turkey have also decreased in the first 5 months, but not as severely as direct inbound investments.

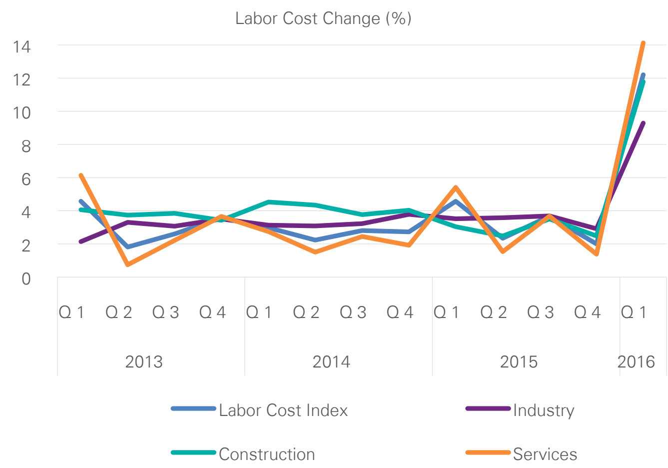
Unemployment



- The unemployment rate in Turkey has been at the level of 9% on average since the global crisis. The seasonally adjusted unemployment rate declined to 8% in 2012, but with the effects of the low growth rate coming after, unemployment rose again, up to 10%. In March 2016, while unemployment was at the 10.1% level, seasonally adjusted unemployment rate was at the 9.7% level.
- Despite the number of employed people having increased by 6 million in the last 6 years, unemployment rates has not fallen because of the increase in the labor force participation. At the beginning of 2010, 47 people out of 100 in Turkey joined the labor force, now it is 52. Within this increase in labor force participation, the major factor of the increase is the women joining the labor force. At the beginning of 2010, 26 out of every 100 women were joining the labor force, now that number is 32.

Labor costs



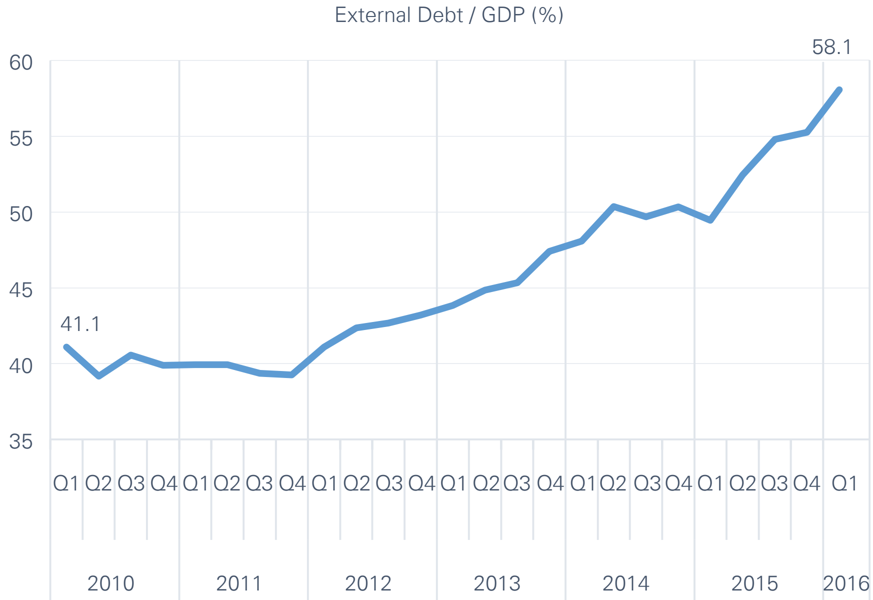


- Labor costs in Turkey are increasing every year. With respect to industries, the industry for which labor costs have increased the most since 2010 is construction. Over the past 6 years, labor costs throughout Turkey have doubled, but this number is 2.4 times more for the construction industry.
- Labor costs were increasing by 3% on average per quarter. But in the first quarter of 2016 the rate reached 12%. The increase of the minimum monthly wage to TRY 1,300 at the beginning of the year was the major factor in this. The industry that has observed the highest labor cost increase due to minimum wage increase has been the service industry. In the service industry, costs have increased by 14.1% year-on-year.

Foreign debt increases

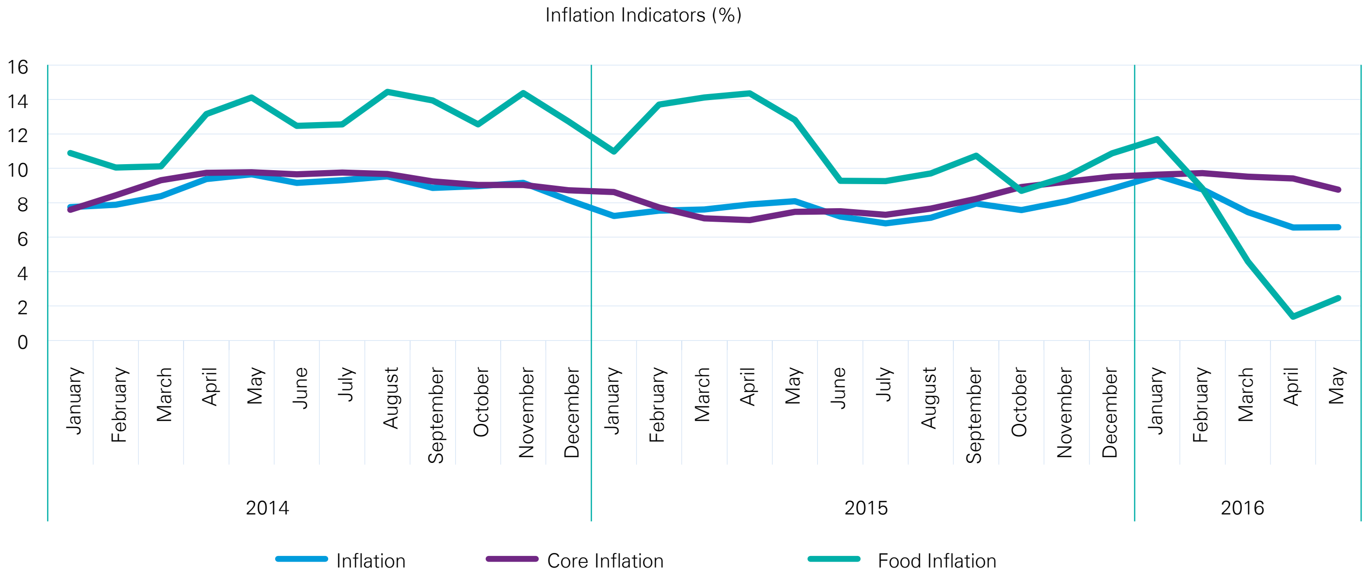
As of the 1st quarter of 2016, Turkey has:

- **a public external debt of 118.2 billion USD**
- **a private external debt of 292 billion USD**
- **a gross external debt of 411.5 billion USD**



- With the precautions of the CBT in 2015, the ratio of short term debt to total debt has decreased from 32.7% to 25.9%, since the end of 2014.
- External debt / GDP ratio of Turkey reached its highest level in 2001 with 57.7%, and its lowest level for 11 years in 2005 with 35.5%. The ratio reached 58.1% in the 1st quarter of 2015, the highest level since 2002.
- While the increase in Turkey's external debt is considered as an important problem in some reports and evaluations, we suggest a calmer approach for two reasons. First, Turkey has a lower debt ratio than many developed and emerging countries. Second, the increase in the last two years has been mainly due to an increase in exchange rates. In other words, there is less increase in the amount of foreign currency owed. But there is a leap in the ratio because USD-based GDP has fallen rapidly.

Inflation



- Inflation, which was at high levels in 2014 and 2015, went through a downward trend in 2016. Food prices increasing over 10% in the previous years was a factor in inflation being at these high levels. In 2016, because food prices dipped, the consumer price index declined to 6.6% in May. However, there is still no solid decline in core inflation. With the effects of USD exchange rate increases fading, a decrease is anticipated in core inflation as well in the coming period. And this means further decreases may be observed in interest rates in the coming period.
- According to CBT Expectations Survey, end of year inflation is expected to be at the level of 7.6%.

Conclusion

We consider the credit rate downgrading of Turkey by the rating agency Standard and Poor's (S&P) to be wrong in terms of both attitude and technical content. This grade was determined the day after the attempted coup and it is really hard to understand what kind of "expertise" and "proficiency" this grade is reflecting. Credit agencies should remember their shares in ongoing economic crises in the world, and they should act responsibly, instead of acting on extremes.

When evaluating the effects of the latest events on the economy, we believe the transition period will be overcome by supportive actions from both the business world and from government authorities and show a responsible attitude instead of taking extreme decisions.

We believe that business life has a responsibility in the democratic, prosperous, just and free future of our country. We will continue to do our best at fulfilling this responsibility.

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 brief a commentary.

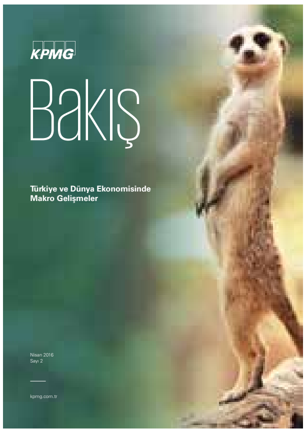
Bakış 1

Turkish

English

Bakış 2

Turkish



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