Bakış

Macro Trends in Turkish and Global Economy

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General Outlook

Following 2016, which was a tough year for the world economy and especially for developing countries, it is expected that global economies will rebound supported by rising oil and commodity prices. Countries such as Russia and Brazil, whose economies have shrunk over the past two years, are expected to grow again in 2017, while the United States, which has grown below expectations this year, is expected to grow stronger this year. The upsurge in oil and commodity prices will also push up dollar-based global trade growth. According to estimates, it is expected that world trade will increase by around 10% to $17.7 trillion if fuel prices float at $55 p/barrel throughout the year.

While the world economies are on a recovery trend overall, 2017 gives us more reason for hope for the Turkish economy in the aftermath of 2016 which saw rising diplomatic tensions with Russia and Iraq, a wave of terror events shaking the country, and a coup attempt. With the constitutional referendum behind us, and deferred spending and investment decisions taking effect, we anticipate a strong domestic demand from the second quarter, and while there is a noticeable revival in the markets in the first quarter thanks to government loans, a strong export performance points to a positive contribution to the growth of net exports. In short, we hope that 2017 will be more promising than 2016 in terms of both the global and Turkish economy.

I hope you enjoy reading the report,

Murat Alsan
Chairman, KPMG Turkey

Global

2016, the year that saw the lowest growth rates in global economy due to low oil and commodity prices, is now behind. In 2017, oil and commodity prices are on the rise again. Oil and commodity exporting countries whose economies suffered last year are expected to experience a recovery this year. Thus, it is anticipated that global growth will rise, especially in developing countries. According to the IMF's Global Economic Outlook report released in April, the global economy, which grew by 3.1% in 2016, is expected to grow by 3.5% in 2017. The Brazilian and Russian economies, which shrank in 2015 and 2016, are expected to grow again in 2017.

Looking at the US, while growth figures in 2016 are below expectations, declining inflation and improvements in the labor market indicate that things are going well for the US economy. In December 2016, the FED was expected to raise interest rates three times in 2017 starting from June. However, FED authorities took the market by surprise by making the first interest rate increase in March. As for developments in global trade, it is expected that world trade, which has shrunk in dollar terms for the past two years, will increase by around 10% to $17.7 trillion if fuel prices float at $55 p/barrel throughout the year. As a matter of fact, according to the data from January, global trade has increased in a similar way, especially driven by countries exporting oil and commodities.

Turkey

In the last quarter of 2016, the Turkish economy grew above expectations by 3.5%. The 5.7% growth in consumption, which constituted a significant part of GDP in the fourth quarter, was the most important factor driving growth. Thus, on a yearly basis, the Turkish economy grew by 2.9% in 2016. Despite developments such as the diplomatic crisis with Russia and Iraq, domestic terrorism, intervention in Syria, and even an attempted coup, Turkey's economy showed a better growth performance than many countries in 2016. Public spending recorded double-digit growth in the first half of the year, with a weak performance of 0.8% in the last quarter. Investments also saw a relatively high growth rate during the first half of the year, while they tapered off in the third and fourth quarters. Net exports (1.35) contributed negatively to growth, especially due to the negative trends in the tourism industry in 2016 - its worst performance over the last 10-year period, while domestic demand contributed positively (3.27 points). In 2017, government expenditures will have a high share in growth, just as they did in 2016.,

In particular, tax cuts and incentives delivered over the first half period will raise the share of public spending in growth.

The recovery of losses in markets such as Russia and Iraq in 2016 and the improvements in the EU market will bring about strong growth in exports, however the tourism industry is not expected to rebound from its recent slowdown. There is a chance we can see the industry making a better recovery during the second half of the year. Despite poor growth figures in the tourism industry, we think net exports in 2017 will contribute positively to growth. We are expecting to see a growth rate of 3.7 in 2017. There was a small increase in 2016 in the current account deficit, one of the critical performance indicators for the Turkish economy.

In 2017, along with the rise in oil prices, a remarkable increase is anticipated in imports and the foreign trade deficit. Unless we see a recovery in the tourism industry, it is inevitable that the current deficit will increase to $36 billion.

Turkey in the wake of the referendum

Occupying the top spot on the country's agenda since the start of 2017, voting for the referendum on a new presidential system is finally over. With the "yes" decision, expectations that had already been priced in by the markets prior to the referendum were realized and there was no significant change in exchange rates.

Now that the referendum is over, Turkey's main agenda is expected to return to the economy again. Decisions such as the attraction-centers, project-based super incentive system and the restructuring of tax debts announced by the government in 2016 have begun to show their impact in the first quarter of 2017. Reductions in excise duty introduced for durable goods, as well as the Job Creation Initiative, which was put into effect before the referendum in 2017, went a long way towards buoying the markets.

The future of relations with the EU will play an important role in the course of the Turkish economy in the coming months. The number of tourists from EU countries are lagging behind the 2016 figures, mainly due to the straining of relations with the EU countries, especially the Netherlands and Germany, before the Negotiations on the renewal of the Customs Union agreement are more likely to be a success if the relations with the EU can be put back on track again in the upcoming period. On the other hand, a decrease in diplomatic tension will have a positive impact on tourism. Last year's losses in tourism have brought about a 1 point drop in growth. Hence, the recovery of the tourism industry in 2017 will play a vital role in bringing back growth.

Another important issue is that loans given by the government to the business world, especially SMEs, have remarkably increased through the Credit Guarantee Fund. Under normal circumstances, it is foreseen that there will be no further depreciation of the Turkish lira in the current situation. However, the tension with the EU and the fact that Turkey will embark on new operations in Syria may put additional strains on the Turkish lira and this pressure may further aggravate the risk that the government-guaranteed loans granted to the market may not be repaid by businesses. Therefore, the most decisive issue for the rest of the year in 2017 will be foreign policy.

Expectations

To summarize, the year 2017, which will see rising oil and commodity prices, will be a much more productive year than in 2016, both in terms of global growth and global trade. With the improvement in the global economy, Turkey's economy will grow at a higher rate than in 2016, thanks to both domestic and external demand. Indeed, expectations at the beginning of the year can take a positive or negative course depending on the developments that unfold throughout the year. 2017 has significant risks due to the country's current precarious situation.

The tension between North Korea and the US, Trump's protectionist and isolationist policies, Brexit, and the course of the war in Syria create uncertainties both in terms of the global and the Turkish economy. On the other hand, the course of foreign policy in the wake of the referendum is extremely important for the future of the economy. For Turkey, which makes about half of its exports to the EU and receives about 70% of its direct investments from the EU, its relations with the EU in the coming period will be a determining factor in how the economy performs.

Expectations in 2017

Growth

In 2017, government expenditures will have a high share in growth, just as they did in 2016. In particular, tax cuts and incentives delivered over the first half will raise the share of public spending in growth.

The recovery of losses in markets such as Russia and Iraq in 2016 and the improvements in the EU market will bring strong growth in exports, while the tourism industry is not expected to rebound from its recent slowdown. To conclude, we think net exports in 2017 will contribute positively to growth.

Foreign Trade

In 2017, export and import prices are following an upward trend and the increase in export and import prices will increase export and import figures in dollar terms. However, import prices will rise faster than export prices.

Compensation for losses to neighboring countries in exports, the increase in export prices, a recovering EU economy, and the rising demand of oil exporting countries are the factors contributing to the jump in export figures. The rise in oil and commodity prices, on the other hand, will be the main factor determining the rise in imports.

Growth expectation for 2017

3.7%

GDP estimate

$810 billion

2017 foreign trade expectations

Exports **$155** billion

Imports **$210** billion

Markets (year average)

USD/TRY	: 3.60
EUR/TRY	: 3.82
EUR/ USD	: 1.06
Oil	: $55

Unemployment

10.7%

(year average)

Current Account Deficit

35.8

(Billion USD)

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