

WEEKLY OUTLOOK

Probability of Fed rate hike in June soars.

The minutes of the April FOMC meeting published last week was watched closely by the markets. According to the meeting minutes, FOMC members indicated that labor market conditions have improved further although economic growth appears to have slowed in the first quarter. Export demand and industrial production decreased due to the appreciation in dollar. Mining output also continued to contract because of the declining oil prices. FOMC members asserted that inflation continued to run below the Committee's 2% objective, reflecting declines in energy prices and falling prices of non-energy imports. Moreover, economic projections of FOMC members improved. Members, expecting an accelerating GDP growth in Q2, believed that US economy will grow beyond its potential in medium term due to the positive outlook in consumer spending. Inflation, on the other hand, was expected to pick up in tandem with the recently rising oil prices. In meeting minutes, which underlined that uncertainty in global markets has diminished, it was notable that two FOMC members argued that the removal of policy accommodation was proceeding slowly.

US economic data published last week exhibited a positive outlook in general. Industrial production in April increased above the expectations by 0.7%. Housing starts reached 1.18 million, showing that construction sector is picking up. CPI in April rose in line with the higher oil prices. US CPI was realized as 0.4% mom, the highest in the last 38 months.

US yield curve, which became flattest in the last 9 years, was considered as a result of a mispricing while Fed was expected to get more hawkish. Fed governors, Williams and Lockhart, explained that two or three interest rate hikes seem reasonable in this year if the US economy continues to expand and unemployment rate keeps its low levels. While Fed's interest rate hike probability is expected to become more emphasized this week, the markets will focus on the Janet Yellen's speech on Friday.

Emerging markets face selling pressure...

Appreciation in US dollar since the beginning of May was also continued in the last week. As the investors were seeking a safe haven, MSCI emerging market index declined by 3.5%. European stock indices were relatively flat due to the strengthening expectation that UK will remain in the EU after the referendum in June. Moreover, fragile Italian banking sector was supported by the Unicredit's consideration to sell part of its assets in Yapı Kredi Bank in an attempt to fund-raise for its capital increase. Last week, EUR/USD declined by 0.7% to 1.12.

While Chinese markets performed relatively better last week, recent news indicated that the economic activity stabilizes in China. Data about housing sector which made the highest contribution to the Q1 economic growth also confirms these views. New home prices went up by 6.2% yoy in April, the highest increase in the last 23 months, while price hikes were at double digit levels in big cities like Beijing and Shanghai.

WEEKLY DATA

	13 May	20 May	Change		13 May	20 May	Change
BIST-100 Index	77,808	76,358	-1.9 % ▼	EUR/USD	1.1305	1.1222	-0.7 % ▼
TRY 2 Year Benchmark Rate	9.76%	9.79%	3 bp ▲	USD/TRY	2.9687	2.9752	0.2 % ▲
US 10 Year Bond Rate	1.71%	1.85%	14 bp ▲	EUR/TRY	3.3563	3.3382	-0.5 % ▼
EMBI+ (bps)	390	396	6 bp ▲	Gold (USD/ounce)	1,273	1,252	-1.7 % ▼
EMBI+ Turkey (bps)	310	310	0 bp ●	Brent Oil (USD/barrel)	46.9	48.4	3.2 % ▲

bp: basis point

Crude oil prices continued to increase.

Crude oil prices continued their upward trend in last week. Brent crude oil price declined slightly after increasing to 48.8 USD/barrel in mid-week, the highest level in the last 7 months. Oil supply reduction due to the wildfire near oil sands in Canada and a rise in oil imports of China to boost oil stocks were influential on the increase in oil prices.

Gold prices, on the other hand, declined after announcement of FOMC meeting minutes which led the dollar to appreciate against other developed countries' currencies. We consider that the appreciation of US dollar due to a possible Fed interest rate hike will cause a decline in commodity prices, especially prices of precious metals. However, we project that rising seasonal demand from Asian countries may limit this effect.

Decrease in unemployment rate in Turkey...

According to Turkstat data, in February unemployment rate was realized as 10.9% decreasing by 0.3 points yoy. Seasonally adjusted unemployment rate, on the other hand, was realized as 9.9%. During the same period, non-agricultural unemployment rate also decreased to 12.7% following a declining path. In Turkey, labor force increased by 877,000 persons yoy while labor force participation rate reached 50.8%. Analyzing the developments in labor market in terms of economic activities, it is seen that employment in all sub-groups except industry sector increased on a yearly basis. During this period, employment in services sector increased by 738,000 persons.

Deterioration in exchange rate expectations...

Parallel to the improvement in global risk perception, capital flows to developing countries including Turkey gained pace in March and April. During this period, with increasing investors' demand for TRY denominated assets, interest rates declined and TRY appreciated. However, the rising political tension in Turkey as well as Fed's cautious announcements regarding its monetary policy in the coming period caused deterioration in expectations recently. USD/TRY expectation for the year end of 2016, which was following a downward trend in the last 3 months, has increased to 3.11 in May for the first time according to the results of Central Bank's Expectations Survey. While the economic growth expectations of the respondents for 2016 remained stable at the level of 3.6%, the CPI expectation declined to 7.80% in line with the developments in food prices. In addition, weighted average funding rate expectation for the current year declined by 17 basis points to 8.48% compared to the previous month, reaffirming markets' expectation that the Central Bank will continue to cut interest rates at its meeting on May 24th. However, we believe that the increasing possibility of Fed's interest rate hike would restrict Central Bank's room for maneuver.

Strong performance of central government budget continues.

According to the central government budget figures, in April, budget gave a surplus of 5.4billion TRY. Thus, primary balance posted a surplus of 8 billion TRY increasing by 7.8% yoy. Regarding the first four months of the year, primary surplus achieved 93.3% of budget target, reaching 24.6 billion TRY. In April, tax revenues contributed to budget performance slightly, while other revenues increased by 56.1% yoy thanks to the transfer of CBRT's profit for 2015 to Undersecretariat of Treasury. Privatization revenues, which contributed budget performance significantly in previous months, remained flat in April. Another factor behind the favorable performance of central government budget was the 55.9% yoy decrease in interest expenditures. On the other hand, expansion in personnel expenses, current transfers, purchases of goods and services limited the solid budget performance ([Our Budget Balance Report](#)).

INDUSTRY NEWS

The share of HPs increases in electricity production.

Minister of Forestry and Water Affairs Veysel Eroğlu stated that hydropower plants (HP) contributed to the Turkish economy by 6 billion TRY in 2016, as the electricity produced by those facilities reached 27.7 KWH during this period. Eroğlu stressed that Turkey did not use its potential of the hydropower in the past; however the share of domestic energy production facilities followed an increasing trend thanks to the ongoing investments. Eroğlu noted that Turkey's total electricity production was 94.2 billion KWH, as the HPs constituted 29.4% of it, the highest level in the last 11 years.

Difficulties in the cement sector...

Turkish cement sector, which was the top exporter in the world until 2013, continues to lose its global market share. Export volume of the sector, which narrowed significantly during the last 5 years due to the unrest in Middle East, is expected to have more trouble after the Iraqi government's new bill on banning cement imports. The cement exports to Iraq, declining by 90% in the last 5 years, came in at 23 million USD in 2015. Last week cement sector received another bad news from the Competition Authority. It was stated that an investigation was initiated in order to determine any violation of the competition law by Competition Authority on some ready-mixed concrete firms in İzmir region whose demand was buoyant due to the urban transformation projects.

New hotel projects...

The investments in tourism sector remained sound despite the elevated political tensions with Russia and security concerns.. According to the sector officials, the sector's total bed capacity is estimated to be around 1.64 million in 2018, should the current crises be short-lived. During this period the bed capacity in Antalya and İstanbul is expected to increase by more than 100k to 589k and 216k, respectively. The accommodation capacity in other touristic regions such as Muğla, İzmir and Aydın, on the other hand, is anticipated to rise at a more moderate pace. Furthermore, recent data published by the Hotel Association of Turkey suggested that the hotel occupancy ratio continued to decline. In April, hotel occupancy ratio decreased to 52.2% down by 22% yoy. Hotel occupancy ratio in İstanbul, tourists most preferred destination, was realized as 50.3% and the average accommodation price in İstanbul declined by 12% yoy.

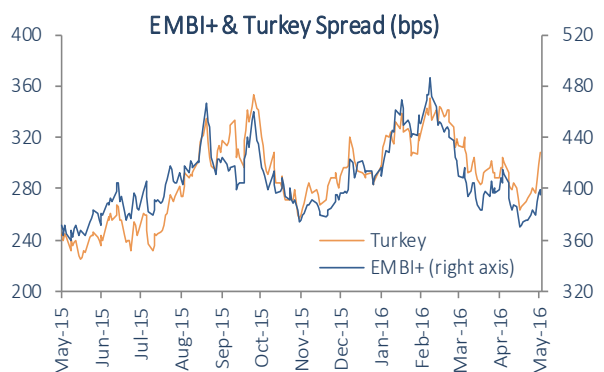
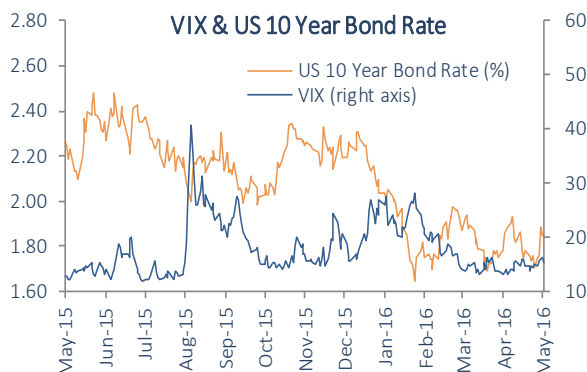
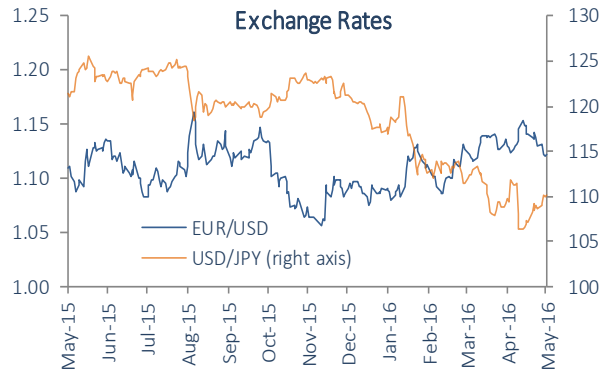
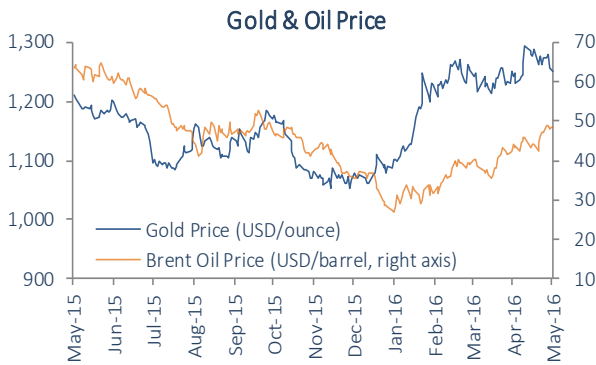
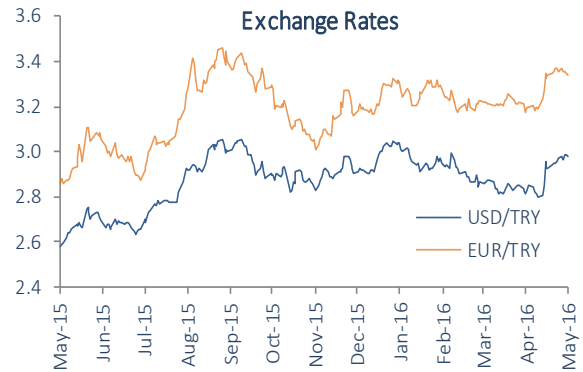
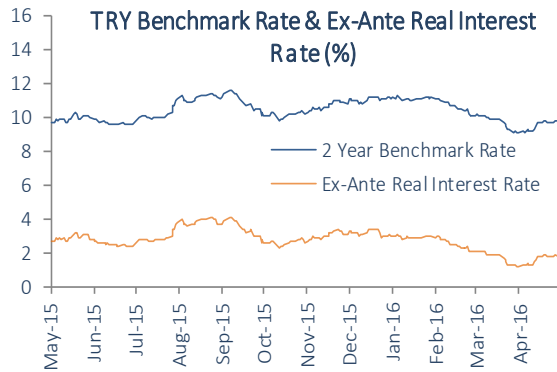
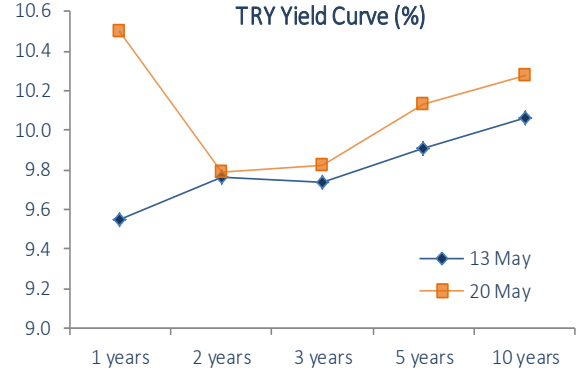
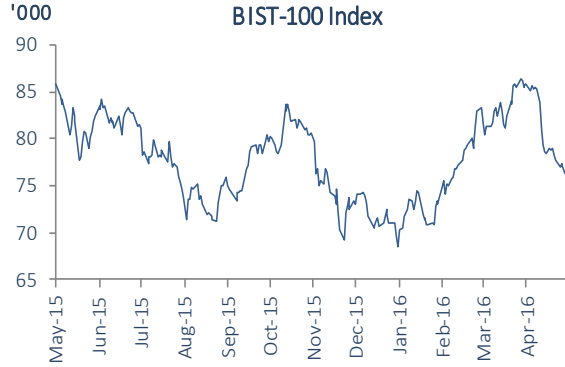
The issuance of covered bonds may increase in Turkey.

Moody's stated that the mortgage loans are some of the Turkish banks' "most creditworthy assets", as the issuance of covered bonds may increase in the coming period. Besides, Moody's emphasized that Turkey's surging house prices are unsustainable, but market and regulatory dynamics would help prevent a housing slump. It was also noted that the favorable demographics and the low weight of mortgages in Turkey's financial system lessen the risk of a housing-related slump in Turkey like those seen in the US or Spain.

New era in the labor law...

The bill on labor law, which will pave the way rental workers, legislated and published in the Official Gazette on the May 20th. According to the regulation, the rental labor system will become possible through private employment bureaus. In the new era, thanks to the enhancement in the labor market flexibility, the number of informal workers is anticipated to decrease while total employment is anticipated to increase by 300k persons.

FINANCIAL MARKETS



WEEKLY DATA RELEASES

		Period	Consensus
23 May	Turkstat Consumer Confidence Index	May	68.75 (A)
24 May	CBRT MPC Meeting and Interest Rate Decision	May	
	Euro Area Manufacturing PMI (preliminary)	May	
	Germany ZEW Index	May	
	Germany GDP Growth	2016 Q1	
	US New Home Sales	April	
	US Manufacturing PMI (preliminary)	May	
25 May	Turkstat Sectoral Confidence Indices	May	
	CBRT Capacity Utilization Ratio	May	
	CBRT Business Tendency Survey and Real Sector Confidence Index	May	
	Treasury's Domestic Debt Redemption (654 million TRY)		
26 May	US Durable Good Orders	April	
27 May	US The University of Michigan's Consumer Survey	May	
	US GDP Growth (Revision)	2016 Q1	

(A) Actual

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