

	29-Jun	6-Jul	Change		29-Jun	6-Jul	Change
BIST-100 Index	96,520	98,734	2.3 % ▲	EUR/USD	1.1683	1.1745	0.5 % ▲
TRY 2 Year Benchmark Rate	19.25%	19.94%	69 bp ▲	USD/TRY	4.5862	4.5674	-0.4 % ▼
Turkey 5-Year CDS	290	283	-7 bp ▼	EUR/TRY	5.3570	5.3683	0.2 % ▲
MSCI EM Equity Index	1,070	1,060	-0.9 % ▼	Gold (USD/ounce)	1,252	1,254	0.2 % ▲
US 10-Year Bond Rate	2.85%	2.83%	-2 bp ▼	Brent Oil (USD/barrel)	77.5	75.1	-3.1 % ▼

bp: basis point.

Protectionist trade policies implemented by the US are raising concerns that trade conflicts will progress further. As the US began to implement tariffs on 34 billion USD worth of imports from China starting July 6, markets have been focusing from now on the steps that will be taken by both parties. Despite not being in the spotlight because of trade tensions, non-farm payroll data exceeded expectation, but average hourly earnings lost momentum. Accordingly, employment figures have put downward pressure on the US dollar on the last trading day of the week. In Turkey, inflation figures which came in well above estimates and expectations ahead of the CBRT meeting in July were the main drivers of the markets.

Increase in trade tension is on the agenda of global markets.

Trade tensions, which have been the main agenda of global markets recently, continued to be in the spotlight last week. US tariffs on more than 800 Chinese products worth 34 billion USD on July 6 and China's statement that it will react accordingly have increased concerns that trade tensions are escalating. In addition, European Commission accepted a provisional package of measures limiting the steel imports of European Union countries. In line with this decision, additional 25% custom duty tax will be levied for steel imports exceeding a certain quota. In addition, as US has been considering to withdraw from World Trade Organization (WTO) following some countries filed a complaint to WTO regarding US', protectionist policies increased uncertainty in the markets.

Possible increase of trade tensions is considered as a risk factor that can limit global economic growth. In addition, capital flows to emerging markets in such an environment might be disrupted. Moreover, it is worrisome that volatility in financial markets in China could lead to uncertainty that could affect global markets like it did back in August 2015.

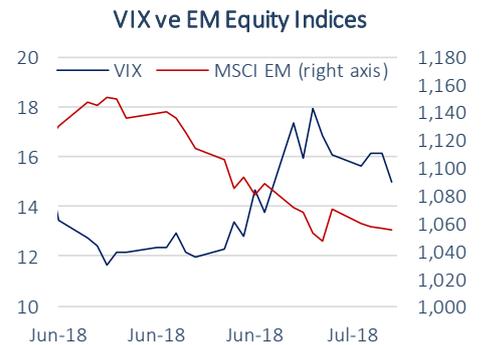
FOMC minutes are released.

Fed issued minutes of its meeting held on June 12-13. Accordingly, it has been stated that economic activity has been rising at a solid pace and rate hikes will continue as predicted. On the other hand, Fed members think that uncertainty associated with trade policy are increasing and might have a negative impact on the economic activity. The minutes did not cause markets to fundamentally revise their expectations on future policy decisions. While Fed raised its interest rates for the second time this year at its last meeting in June, its members predicted 2 more rate hikes for the remainder of the year.

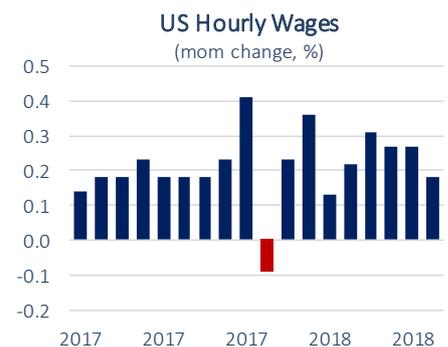
In US, employment and production data were followed closely last week. Although ADP private sector employment data remained below expectations with 177K in June, non-farm payroll data for the same period exceeded the expectations with 213K increase. On the other hand, deceleration in earnings growth meant that Fed will continue rate hikes gradually. This development resulted in the US dollar to depreciate against major currencies.

Oil prices...

Uncertainties over global trade tension and OPEC's latest decision on rising oil supply put a downward pressure on oil prices last week. However, supply disruptions in Libya, Venezuela, Canada and Angola as well as declining crude oil inventories in the US have eased the pressure on prices to some extent. As a result, Brent crude oil price fell by 3.1% w/w to 75.1 USD/barrel last week.



(*). DXY index keeps track of the US dollar's performance against a basket of six currencies (euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc).



Source: Datastream

Growing concern over the acceleration of inflation in domestic markets...

In June, CPI rose above market expectations by 2.61% on a monthly basis, the fastest increase since October 2011. Monthly increase in D-PPI became 3.03% in this period, exceeding estimates. Thus, on annual basis, CPI and D-PPI surged by 15.39% and 23.71%, respectively, reaching their highest levels in 2003 based series. In June, while prices in all main expenditure groups except clothing and footwear increased on a monthly basis, food and non-alcoholic beverages group continued to play a significant role in inflation. The rise in unprocessed food prices was worth mentioning in June, CBRT's favorite core inflation indicators, B and C, continued to deteriorate. ([Inflation Report](#))

Decline in real effective exchange rate continues...

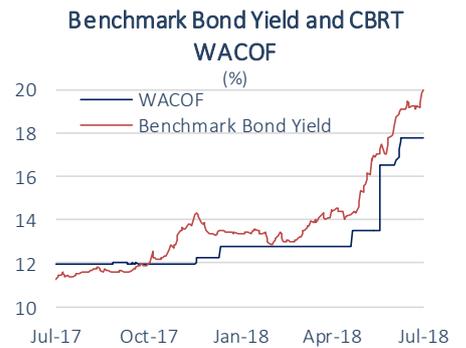
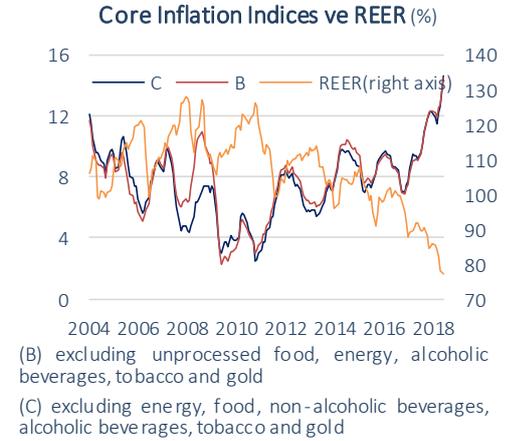
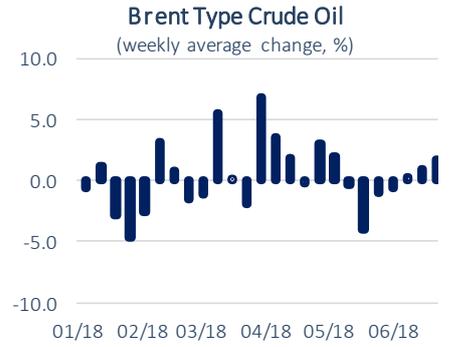
Downward trend in CPI based real effective exchange rate (REER) continued in June. Sharp depreciation in TRY and rising inflation were the main drivers behind this development. REER went down by 1.4% mom to 77.1, hitting all-time record low according to 2003 based-series. Fall in real effective exchange rate indicates a depreciation in TRY in real terms which actually means dedining prices for Turkish products in terms of foreign products.

Domestic markets...

Last week, concerns over global trade tensions and higher-than-expected inflation figures were the two major developments which affected domestic markets. USD/TRY, already having a rising trend due to the deterioration in global risk appetite, tested above 4.70 after inflation hit its historic high. Yet, strengthening expectations about an upcoming rate hike from the CBRT in order to control inflationary pressures helped TRY to recover partially. Consequently, USD/TRY completed the week below 4.60. Moreover, record high inflation drove 2-year benchmark bond yield to 20%, the highest level recorded for the last 10 years. On the other hand, stock exchange continued its upward momentum thanks to diminishing political uncertainties following the election results. BIST-100 index closed the week 2.3% higher.

This week's agenda...

This week, there are no significant data releases either locally or in the global markets. Domestic markets will focus on current account figures, Treasury auctions and political developments. Particularly, all eyes will be on the new economic management team.

**Data Releases**

		Period	Consensus	Prior
9 July	Euro Area Sentix	July	8.2	8.2
	TR Bond Issuance	July	-	-
10 July	UK Industrial Production (mom change, %)	May	0.7%	1.4%
	TR Bond Issuance	July	-	-
11 July	CBRT Current Account Deficit	May	-	5.43 billion USD
	US PPI (annual)	June	3.2%	3.1%
12 July	Euro Area Industrial Production (annual % change)	June	2.2%	1.7%
	US CPI (annual)	June	2.8%	2.8%
	US Weekly Earnings	June	0.2%	0.1%

Source: Datastream, Turkstat, CBRT

Sectoral Developments

A sharp decline in automobile sales...

According to the Automotive Distributors' Association data, automobile sales dropped by 37.7% yoy to 41,225 units in June, recording the biggest decline since December 2008. Automobile sales, which increased by 5.5% yoy in the first quarter of 2018, declined by 19.2% yoy in the second quarter, confirming the slowdown in economic activity. In addition to the depreciation of the TRY, recent tax regulations and rise in financing costs played part in this contraction. Moreover, as escalation in trade tensions would harm automotive sector it is cited as an important risk factor for the sector.

Increase in exports of defense and aviation...

According to the Turkey Exporters' Assembly data, Turkey's defense and aviation industry exports expanded by 14% yoy to 906 million USD in the first half of the year. Exports to the USA, the largest export market of the sector, increased by 8% yoy to 343 million USD in this period. Strong export performance of the sector is expected to persist in the forthcoming period. Indeed, Defense Minister Nurettin Canikli stated that Turkey has won the tender opened by Pakistan Navy's to supply four corvettes. Canikli said that the deal will be the largest defense export of Turkey in one agreement.

SCT on cigarettes has been changed.

The Ministry of Finance increased two of the three Special Consumption Tax (SCT) types collected from the cigarettes, while reducing one of them. The proportional tax rate was reduced from 65.25% to 63% while the minimum lump-sum tax per cigarette was increased from 0.22 TL to 0.28 TL and the lump-sum tax per package was also pushed up from 0.32 TL to 0.42 TL. Thus, the total amount of SCT per pack cigarette was lifted from 5.18 TL to 6.02 TL. It is calculated that the regulation led an increase in tax revenues collected from the cigarettes with a price less than approximately 8.9 TL and a decrease in the tax revenues from the cigarette which is higher than that price. Finance Minister Naci Ağbal stated that this regulation is expected to impose a limited additional burden on the budget amounting 150 million TL.

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