

	27-Jul	3-Aug	Change		27-Jul	3-Aug	Change
BIST-100 Index	95,585	95,610	0.0 % ▲	EUR/USD	1.1656	1.1567	-0.8 % ▼
TRY 2 Year Benchmark Rate	20.41%	21.68%	127 bp ▲	USD/TRY	4.8519	5.0805	4.7 % ▲
Turkey 5-Year CDS	310	330	20 bp ▲	EUR/TRY	5.6555	5.8759	3.9 % ▲
MSCI EM Equity Index	1,092	1,073	-1.7 % ▼	Gold (USD/ounce)	1,223	1,213	-0.8 % ▼
US 10-Year Bond Rate	2.96%	2.95%	-1 bp ▼	Brent Oil (USD/barrel)	74.4	72.4	-2.7 % ▼

bp: basis point.

Last week, despite keeping interest rates on hold, Fed's hawkish stance drew attention. While global markets focused on the effects of ongoing US-China trade disputes, hot topic in the domestic markets was the announcement of US sanctions on Turkey and uncertainties regarding the scope of these sanctions. The upsurge in costs which occurred as a result of the significant rise in exchange rates that has been seen more clearly starting from Q2, went on putting upward pressure on inflation. It was quite notable to observe that CBRT raised its year-end inflation forecast by 5 points to 13.4% in the latest edition of its Inflation Report in an environment where inflation outlook and expectations have both deteriorated.

Central bank meetings were monitored closely.

In its last meeting, the Federal Reserve (Fed) kept the policy rate on hold but its remarks on US economic outlook drew markets' attention. In its minutes, addressing to the buoyant household consumption expenditure, Fed stated that the US economic growth has been strong and inflation approached to 2% target rate. A more hawkish stance was set forth compared to Fed's earlier minutes and this was taken as a sign for a possible rate hike in the upcoming FOMC meeting to be held in September. Although non-farm payrolls were announced below the market expectations, average hourly earnings that came in line with expectations also pointed out that Fed is likely to continue to follow its gradual rate-hike path.

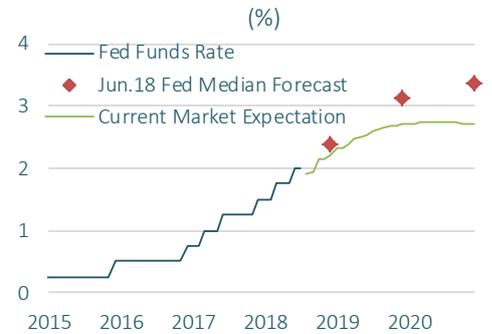
Bank of Japan (BoJ) did not change its policy rate either. Accordingly, BoJ kept its short term policy rate applies to the balances in current accounts held by financial institutions at the Bank—unchanged at 0.1% and yields on 10-year treasury bonds at around 0%. Citing the potential volatility which might occur in the long-term interest rates due to economic activity and price developments, BoJ added a statement such that the asset purchase programme would be implemented as flexible. BoJ also stressed its commitment to keep rates at “very low” for now.

Bank of England (BoE), on the other hand, raised policy rate from 0.5% to 0.75% as expected. BoE made no changes regarding its asset purchase programme worth of 435 billion Sterling. Referring to the uncertainties tied to Brexit talks, BoE signalled a more patient stance in terms of raising interest rates by saying future rate-hikes would be gradual and limited.

Consumer inflation came in below expectations.

In Turkey, monthly CPI inflation was 0.55%, below the market expectations while monthly inflation in producer prices came in at 1.77% in July. Thus, annual inflation in consumer prices rose from 15.34% in June to 15.85% in July, while annual inflation in producer prices increased from 23.71% to 25% in this period. The transportation group made the highest contribution to the monthly inflation, followed by housing, hotels and restaurants and furniture groups. Clothing and food prices, on the other hand, had a downward impact on inflation figures in July. We think that the upward pressure on inflation figures will increase in the coming months. We estimate that the hikes in electricity and natural gas prices in July will drive inflation up by about 0.4 pp in August. Thus, we expect that the adjustments

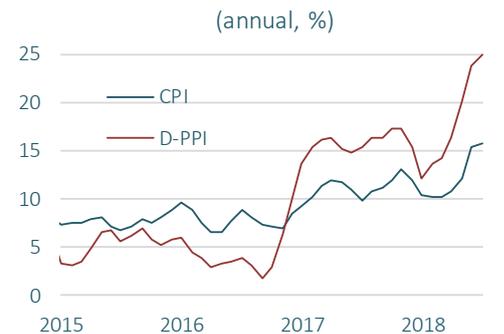
Fed Funds Rate and Expectations



US 10-Year Bond Rate



Inflation Rates



Source: Datastream

in administrative prices such as electricity, water and natural gas prices and the exchange rate pass-through effect will lead inflation to rise in the forthcoming period. We foresee that the depreciation in Turkish Lira since the second quarter of the year will increase consumer inflation by 5.0-5.5 pp in the next 12 months. However, we expected the lagged effects of the CBRT's 500 bps policy rate hikes in the second quarter of the year and the slowdown in domestic demand to alleviate the upward pressure stemming from FX rates ([Our Inflation report](#)).

CBRT revised up its inflation projections.

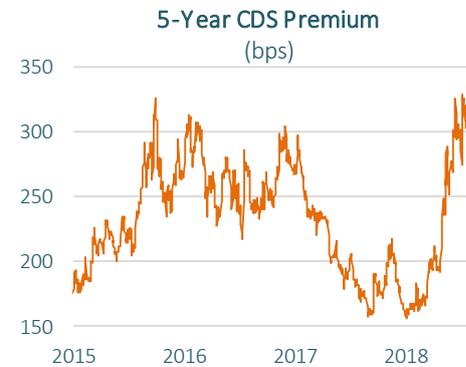
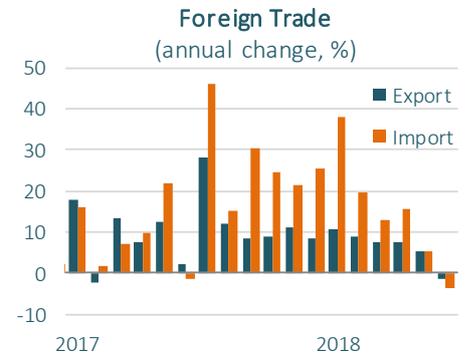
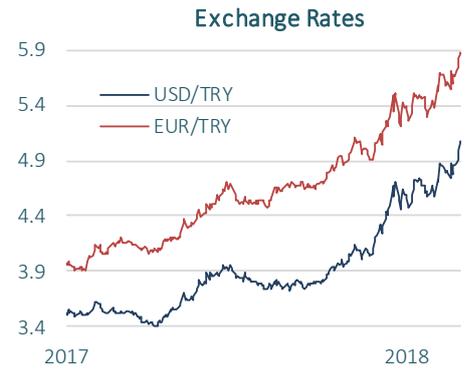
Last week, CBRT published third Inflation Report in 2018. CBRT increased its year-end inflation forecasts from 8.4% to 13.4% for 2018 and from 6.5% to 9.3% for 2019. CBRT, which forecasts the inflation rate for 2020 as 6.7%, kept its medium-term target unchanged at 5%. CBRT revised up its inflation forecasts due to higher oil prices and exchange rate developments as well as food inflation and deterioration in the pricing behavior. President Murat Çetinkaya stated that fiscal policy and macro-prudential measures will have high importance in terms of price stability in the forthcoming period and further tightening can be done if needed.

Contraction in foreign trade deficit...

In June, export volume contracted by 1.3% yoy to USD 13 billion while import volume declined by 3.8% yoy to USD 18.5 billion. Thus, foreign trade deficit was USD 5.5 billion, narrowing by 9.1% yoy. While net gold imports fell significantly in June, the rise in commodity prices seems to offset this decline. On the other hand, the first annual decline in foreign trade deficit seen in a year confirmed the normalization in economic activity. This development was a positive sign for current account balance ([Our Foreign Trade Balance report](#)).

Markets...

Uncertainties caused by the acceleration in US-China trade disputes still create volatility in the global financial markets. After US's declaration of imposing 25% tariff on Chinese goods which worth of USD 200 billion, China announced tariffs on US goods worth of USD 60 billion in return. DXY index, following a downward course at the beginning of the week, surged again due to the strengthening expectations for a rate hike from Fed in its next meeting and closed 0.5% higher. On the domestic front, TRY depreciated against USD and EUR by 4.7% wow and 3.9% wow, respectively, due to the news on potential US sanctions on Turkey. Yield on 2-year benchmark bond also increased by 127 bps to 21.68%. 5-year CDS spreads for Turkey ascended as well. This week, current account balance figures and Turkey-US relations will be monitored closely.



Data Releases

		Period	Consensus	Prior
6 August	Re-opening of T-bill with 10 Months Maturity	August	-	-
7 August	Re-opening of Fixed Coupon Bond with 5 Years Maturity	August	-	-
	Re-opening of CPI Indexed Bond with 10 Years Maturity	August	-	-
8 August	Treasury Debt Redemptions	August	4,670 million TRY	-
	China Foreign Trade Statistics	July	+27.6B USD	+41.6B USD
9 August	USA PPI, yoy	July	3.2%	3.4%
10 August	CBRT Balance of Payments Statistics	June	-	-
	USA CPI, yoy	July	2.9%	2.9%
	UK GDP Growth, yoy	2018Q2	1.2%	1.2%

Source: Datastream

Sectoral Developments

Furniture industry contracted by 5.8% yoy in the first 5 months of the year.

According to Nuri Öztaşkın, Chairman of Association of Turkish Furniture Manufacturers (MOSDER), the contraction in furniture industry was close to 6% yoy in the first half of the year. Stating that expiration of tax intensive is the main reason of that contraction; Öztaşkın added that increase in raw material prices negatively affected the industry. Representatives in the industry have been saying that a permanent value added tax reduction will have positive impact on the sector. Tax incentive, which was implemented in 2017 and lasted for about 8 months, has helped the furniture industry to achieve a significant growth by increasing its sales by 40%. According to TURKSTAT data, in nominal terms, domestic turnover of the sector increased by 6.4% yoy, while non-domestic turnover rose by 26.2% yoy. However, in real terms, domestic turnover decreased by 3.9% yoy while that of non-domestic increased by 2.1% yoy. This confirms that contraction in the industry is a result of weak domestic sales.

Rapid growth in tourism sector...

In the second quarter of the year, tourism revenues increased by 30.1% to USD 7.0 billion compared to the same period of the previous year. In this period, average expenditure of tourists increased by 4.2% year-on-year to 636 USD. As of first half of the year, increase in tourism revenues was 30.6%, while the number of tourists surged by 30.4%. According to the sector representatives, increase in the number of tourists and revenues will accelerate in the third quarter of the year.

Decline in auto sales continues.

According to figures released by the Automotive Distributors' Association (ODD), automobile and light commercial vehicle market shrank by 35.9% in July compared to the same period of the last year. After following an increasing trend in the first quarter of the year, domestic sales had started to decline at an increasing rate in April, May and June due to tightening financial conditions and effects of rising exchange rates. Domestic market contracted by 30% in the second quarter of the year, falling below 10-year average levels. ODD's domestic market estimate for 2018 is at 956,000 units, which indicates a 15% contraction.

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