WEEKLY OUTLOOK

Positive signals from the US economy…

Data released in US increased the optimism about economic activity before the FOMC meeting this week. In November, the non-manufacturing ISM index maintained its upward trend and reached its highest level for 13 months. According to sub-indices, strong course in the economy seems to be spread to general, while there was a remarkable bounce in new orders. The factory orders data announced for October also recorded the fastest increase in the last 25 months. While the upsurge in aircraft orders is at the forefront, the limited increase in demand for other capital goods indicated that investment spending could be under pressure in the last quarter as well. In addition, open job opportunities and staff turnover rate (JOLTS) data, which is closely monitored to follow the improvements in the labor market, supported the view that the US economy is gaining strength. Nevertheless, it has been observed that the rise in bond yields is reflected in mortgage rates and mortgage applications have declined in recent weeks.

While Fed is expected to increase interest rates at its meeting on Wednesday, the medium-term projections published after the meeting will be closely monitored by the markets. In line with the forecasts that inflation would increase globally, there has been a rapid rise in interest rates recently and the markets wonder Fed's reaction to this situation. Fed stands behind the market rates with the 2 interest rate hike expectation in 2017, according to its forecast in September.

Uncertainties are rising in Euro Area.

Developments in Italy after the referendum on December, 4th, were at the top of the agenda earlier in last week. Prime Minister Renzi resigned after referendum defeat. Concerns about the Italian banking system were seen to have increased due to political uncertainties. As a matter of fact, the investors do not seem to be interested in the restructuring program of Monte dei Paschi, the third largest bank in the country, which needs to raise 5 billion euros in capital until the end of the month. Besides Moody's changed the country's credit outlook from stable to negative, stating that after the referendum Italy's power to make meaningful progress on the structural and economic reforms has reduced and country's vulnerability to shocks has increased..

In the second half of the week, decisions taken at the ECB meeting were decisive in the course of the markets. At the meeting held on Thursday, ECB made "surprise" arrangement on the asset purchase program, while keeping the policy rate unchanged. ECB has reduced asset purchases by 20 billion to 60 billion euros and extended the maturity from March 2017 to the end of the year. After the meeting, ECB President Mario Draghi stressed that the decision does not mean a gradual tapering of the asset purchase program and the program could be re-expanded if needed. Draghi noted that the inflation forecast for the year 2017 was revised upwards and drew attention to the downside risks to economic activity. After the ECB meeting, euro depreciated against the dollar. The difference between the interest rates of Germany and the periphery countries widened with the deterioration of risk perception.

WEEKLY DATA

	2 Dec	9 Dec	Change		2 Dec	9 Dec	Change
BIST-100 Index	73,391	75,727	3.2 % ▲	EUR/USD	1.0670	1.0559	-1.0 % ▼
TRY 2 Year Benchmark Rate	10.93%	10.94%	1 bp ▲	USD/TRY	3.5170	3.4859	-0.9 % ▼
US 10 Year Bond Rate	2.39%	2.46%	7 bp ▲	EUR/TRY	3.7510	3.6806	-1.9 % ▼
EMBI+ (bps)	391	367	-24 bp ▼	Gold (USD/ounce)	1,177	1,158	-1.6 % ▼
EMBI+ Turkey (bps)	387	364	-23 bp ▼	Brent Oil (USD/barrel)	52.6	52.4	-0.4 % ▼

bp: basis point

Oil prices remained flat during the last week.

After surging by 14.7% after the OPEC meeting at the end of November, oil prices, remained stable last week thanks to cautious stance of global investors who focus on the meeting of non-OPEC oil exporters, which was held on last Saturday. In the meeting the parties reached an agreement on a daily production cut of 558,000 barrels. Russia, as confirmed earlier, accepted to implement half of this production cut. Pricing in the futures market was last week's another eye-catching development. Limited rise of oil prices in the futures market showed the cautious stance of the investors against the sustainability of rising oil prices. Shale gas producers in the US, who had cut down the production earlier due to falling oil prices, are expected to start their operations soon. Likewise, it was observed last week that US shale gas producers initiated borrowing for investment after two years of break.

PPI is rising in China.

Producer price index (PPI) in China keeps rising annually since September this year. In November, annual PPI inflation accelerated and reached to its highest level in 5 years by 3.3%. Developments in thermal coal and iron ore prices were the determinant of the inflation in November. After the data, risks on global inflation were observed to be rising, leading to increases in bond yields globally on the last trading day of the last week.

Assessment from Fitch on Turkish Economy…

Fitch, the only rating agency which holds an investment grade for Turkey, revised the outlook on Turkish banking system for 2017 from "Stable" to "Negative". Fitch reasoned its decision on the volatility in financial markets and weakening economic growth referring the heightened risks on the asset quality, profitability and capital structure of Turkish banks. Fitch also stated that the need for short-term foreign-currency wholesale funding may leave Turkish banks exposed to large refinancing risks. Fitch estimated that domestic loan growth will be 10-15% in 2017 in Turkey and emphasized that capital adequacy ratio (CAR) might decrease due to problems related to profitability and possible volatility in the TRY.

CBRT's reserves are falling.

Volatility in capital flows stemming from rising uncertainties in the global markets after the US presidential election had a negative impact on CBRT's FX reserves as well. According to CBRT, as of Dec 2nd total reserves dropped by 7 billion dollar to 113.6 billion dollar, during the last month. Hence, CBRT's reserves fell to its lowest level in the last four years. Falling gold prices in the global markets and discounts in reserve ratios were effective on the developments in CBRT's reserves. CPI based real effective exchange rate index (REER), the weighted average value of the TRY relative to the basket of the countries' currencies and indicating the competitiveness of TRY in the global markets, dipped by 3.2% to 95.2 in November. Thus, REER which fluctuated in between 98.4 and 101.5 in the first 10 months of the year plummeted in November and confirmed the divergence of TRY from other currencies.

New measures for the Turkish economy…

New measures to overcome the problems in the Turkish real sector which are stemming from rising uncertainties recently, were decided in the Economy Coordination Board meeting on December, 2nd. Creating a new credit line up to 250 billion TL theoretically by using Credit Guarantee Fund in order to boost the ability of real sector to reach financial resources was notable among these measures. Moreover, along with the steps like increasing employment and supporting non-performing loans, new measures such as extending subsidies to private investments in manufacturing sector and setting an interest rate limit of 7.5% to public deposits given by state-owned banks were said to be taken.

CBRT announced "Monetary and Exchange Rate Policy" for 2017.

CBRT announced its Monetary and Exchange Rate Policy for 2017. It's been stated that capital flows have been volatile for the last couple of weeks as a result of the rising bond yields in the developed countries influencing the depreciation of TL. Inflation forecast for 2016 left unchanged at 7.5% due to better outlook in food prices. Besides, developments in the exchange rates were said to be effective on inflation especially in the first quarter of 2017. In addition, CBRT explained that a new regulation which was aimed to increase reserves via stimulating contribution of savings into the economy would be implemented. In this context, CBRT announced that it will start accepting standard gold converted from wrought or scrap gold to be collected from banks and locals in exchange for TL.

TL followed a volatile course within a wide band.

During last week, TL followed a volatile course against USD in a wide band. Despite the appreciation in the first half of the week thanks to positive outlook in the global markets, TL lost most of its gains on the following days. Throughout the week, TL rose by 0.9% against USD and 1.9% against euro which was weakening in the global markets. BIST-100 increased by 3.2% to 75,727 due to investor's buying from relatively low levels. 2-year benchmark compound rate on the other hand completed week at 10.94%.

Industrial production rose above expectations.

Calendar adjusted industrial production in October rose above the market expectations by 2% yoy. This figure indicated that industrial sector made a respectively good start to the last quarter of 2016 after contracting in the wake of unsuccessful coup attempt. In October, production of energy and capital goods accelerated whereas durable consumption goods production decelerated. Largest increase in production (24.5% yoy) was recorded at computer, electronic and optical products where new models were launched. Furthermore, similar to its buoyant activity in the previous months, manufacturing of basic pharmaceutical products rose rapidly thanks to the new production facilities.

Turkish economy contracted in the third quarter of 2016.

Turkstat went into revision in GDP calculation methodology along with the transformation of the economy and adaptation of the EU regulations. In this framework, while the base year was changed from 1998 to 2009, it was announced that there is a level shift of 10.8% between the two series in 2012. According to the new methodology, real GDP growth in 2015 increased from 4% to 6.1%. Therefore, the national income per capita surged to 11k USD from 9,257 USD.

Turkish economy contracted by 1.8% in the third quarter of the year due to the increasing uncertainties. Thus, the Turkish economy shrank for the first time in 27 quarters. According to production approach, industrial sector contracted by 1.4% annually in line with expectations, while services (wholesale and retail trade, transportation and accommodation) which have the highest share in GDP declined by 8.4%. On the other hand, public administration, education, human health and social work activities contributed positively to the GDP as well as construction sector in line with recent recovery in the sector. (Our GDP Growth Report)

Current account deficit is in line with expectations.

The current account deficit was recorded as 1.7 billion USD in October, in line with expectations. Thus, 12-month rolling deficit reached 3.8 billion USD. Increase in foreign trade deficit and deterioration in tourism revenues continued to be the main drivers of the deficit. On financing front, while portfolio investments reached 2 billion USD in October, foreign direct investments remained weak. (Our Balance of Payments Report)

INDUSTRY NEWS

Automotive sector continued to support exports.

The automotive sector, which has a significant share in Turkey's exports, is positively affected by the recovery in the European economy, which is the biggest market. According to the statement made by Uludağ Exporters' Association, automotive exports increased by 16.9% yoy in November and reached the highest level of the last 8 years with 2.2 billion dollar. The passenger car segment grew by 51% on annual basis in line with the launch of the new models. While exports to our top three markets (Germany, Italy and France) kept its double digit growth performance, total automotive exports are expected to reach 23 billion dollar in 2016.

Fall in retail sales…

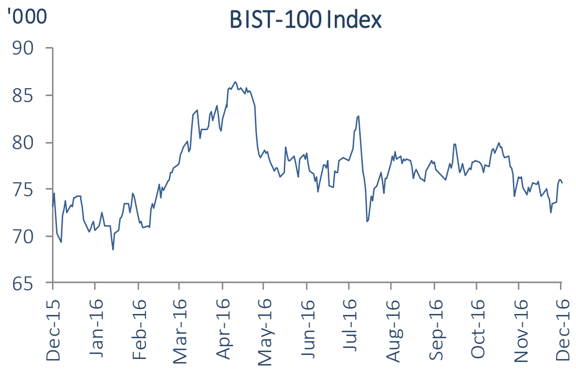
Retail sales, which made a strong start to 2016 thanks to the hike in minimum wage, exhibited a sluggish performance recently. Seasonal and calendar adjusted retail sales volume decreased by 0.8% with constant prices in October 2016 mom. In the mentioned period, food, drinks and tobacco sales decreased by 0.6%. Analysis of the non-food sectors revealed that sales in computers, books, telecommunications equipment groups decreased by 0.1%, medical goods and cosmetic sales decreased by 7.7%, sales via mail orders and internet decreased by 2.1%, while electronic goods and furniture sales and textiles, clothing and footwear sales increased by 0.5% and by 0.9% mom, respectively.

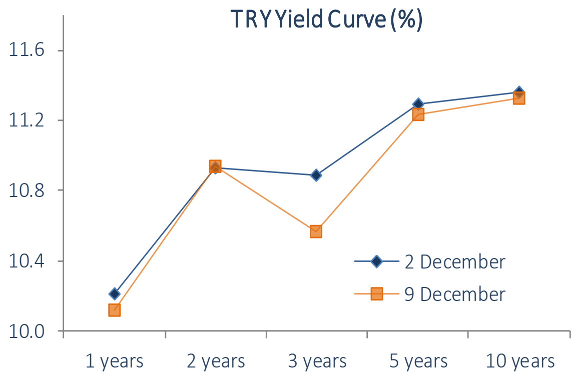
Signs of recovery in iron and steel sector…

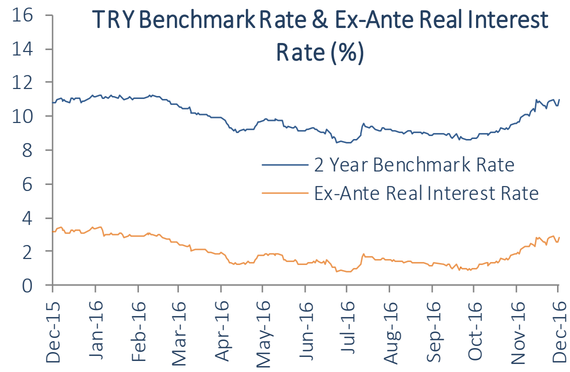
Due to the rise in iron ore prices in global markets, the Turkish iron and steel industry, which mostly uses scrap metal in its production process, gained some advantages in terms of costs, affecting the domestic production activity of the sector positively. Although global crude steel production showed a tendency to retreat in 2016, Turkey was one of the few countries that increased its production thanks to the ongoing infrastructure projects as well as the buoyancy in the domestic automotive sector. China's recent slowdown in imports of steel, stemmed from the significant increase in steel prices, is also a factor that fostered optimism for the domestic steel sector. In October, Turkey's total steel product exports amounted to 1.4 million tons, up by 2.8% yoy. In the same period, on the other hand, imports decreased by 23.3% to 1.3 million tons.

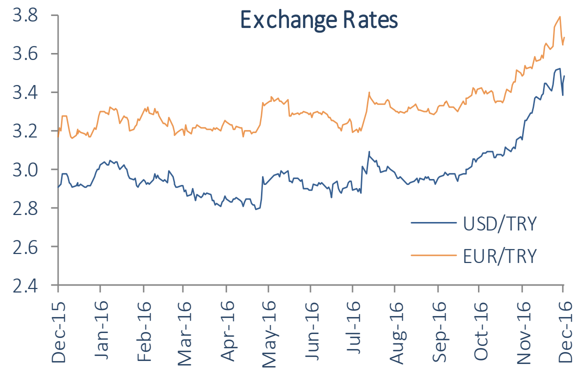
Despite signs of recovery in the Turkish iron and steel sector in 2016, the mid-term risks are still on the agenda. In fact, the news that "a new bubble in iron ore prices" was closely monitored, this might be a threat to the cost advantage that the Turkish iron and steel industry has recently caught up. In addition, the US, which produces steel in a similar way to Turkey, is expected to increase its demand for scrap metal due to the possible pickup in its infrastructure activities, which may hurt production costs in Turkey.

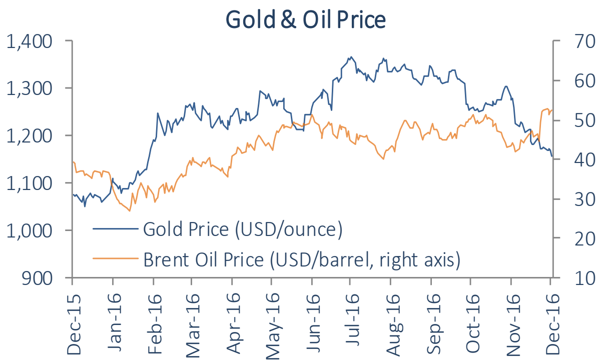
FINANCIAL MARKETS

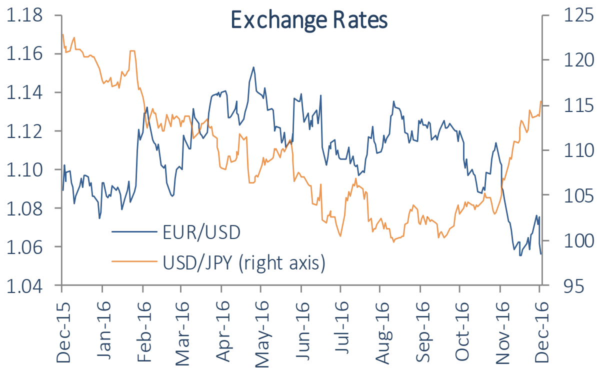


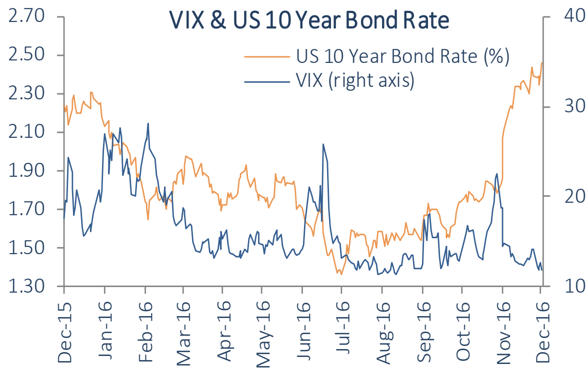


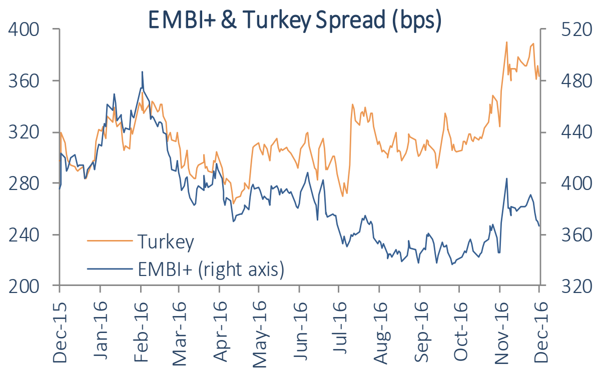












WEEKLY DATA RELEASES

		Period	Consensus
12 December	Turkstat GDP	2016 Q3	-1.8% (A)
	CBRT Balance of Payments	October	-1.7 billion dollar (A)
	Treasury's reissuance of the 5-year bond		
13 December	Treasury's reissuance of the 2-year bond		
	Treasury's reissuance of the 9-year bond		
	Germany ZEW Survey	December	-
14 December	Treasury's Domestic Debt Redemption (4.8 billion TRY)		
	Fed's FOMC Meeting	December	
	US PPI	November	0.1%
	US Industrial Production	November	-0.1%
	US Retail Sales	November	0.5%
15 December	US Capacity Utilization	November	75.1%
	Turkstat Laborforce Statistics	September	-
	CBRT Survey of Expectations	December	-
	Ministry of Finance Central Government Budget Realization	November	-
	US CPI	November	0.2%
16 December	Euro Area CPI	November	-
	US Housing Starts	November	1.24 million units

(A) Actual

İŞBANK - Economic Research Division

İzlem Erdem - Division Head
izlem.erdem@isbank.com.tr

Alper Gürler - Unit Manager
alper.gurler@isbank.com.tr

H. Erhan Gül - Asst. Manager
erhan.gul@isbank.com.tr

Dilek Sarsın Kaya - Economist
dilek.kaya@isbank.com.tr

Aslı Göksun Şat Sezgin - Economist
goksun.sat@isbank.com.tr

Bora Çevik - Economist
bora.cevik@isbank.com.tr

Ahmet Aşarkaya - Economist
ahmet.asarkaya@isbank.com.tr

Ayşe Betül Öztürk - Asst. Economist
betul.ozturk@isbank.com.tr

Our reports are available on our website http://research.isbank.com.tr