TÜRKİYE İŞ BANKASI | research.isbank

	27-Apr	4-May	Change			27-Apr	4-May	Change	
BIST-100 Index	107,614	102,599	-4.7 %	▼	EUR/USD	1.2128	1.1958	-1.4 %	▼
TRY 2 Year Benchmark Rate	14.36%	15.36%	100 bp	▲	USD/TRY	4.0412	4.2230	4.5 %	▲
US 10 Year Bond Rate	2.96%	2.94%	-1 bp	▼	EUR/TRY	4.9032	5.0573	3.1 %	▲
EMBI+ (spread)	348	368	20 bp	▲	Gold (USD/ounce)	1,322	1,315	-0.5 %	▼
EMBI+ Turkey (spread)	320	359	39 bp	▲	Brent Oil (USD/barrel)	75.4	75.4	0.0 %	▼

bp: basis point

Last week data flow from the US economy has shaped the global market's agenda. While policy rate had not been changed in the FOMC meeting as expected, employment dataset which was released on Friday suggested a moderate outlook. In the Euro Area, growth data showed that the economic activity has lost pace and ongoing uncertainties in the monetary policy led to a depreciation in euro. In the domestic market, credit rating downgrade by S&P along with the recent deterioration in inflation outlook put even more pressure on TRY-denominated instruments.

Data in the US...

Fed's FOMC meeting was high on the agenda last week. Upon not changing the interest rates in its May meeting, Fed's comments on US economic outlook were followed closely. Fed drew attention to the strong course in the private consumption expenditures and added that investment expenditures have also recovered such that it will probably contribute more to economic growth in the coming period. It is also emphasized that inflation has approached to the 2%-symmetric target while the "hawkish" tone in the minutes which was published after the meeting was notable. Accordingly, expectations on a rate hike in Fed's next meeting that will be held in June have increased. Moreover, the assumption that policy makers will tolerate a potential rise in inflation for an extended period gained strength further. Yet, Fed minutes lacked a clear sign of how many additional rate hikes there will be in 2018.

In April, rise in non-farm payrolls in the US was lower than expected at 164K. On the other hand, unemployment rate dropped to 3.9% and was recorded as the lowest since 2000. Despite the tightening in the employment market, limited rise in earnings pictured a relatively favourable outlook regarding inflationary pressures which have been monitored carefully lately. In fact, annual change in average hourly earnings was recorded as 2.6% in April.

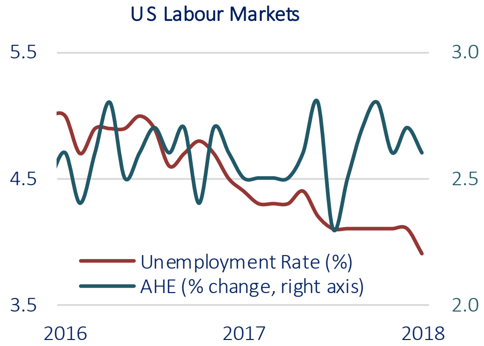
Another development followed in the US was the news that the Treasury would borrow further in the face of an increasing budget deficit. Deterioration in the fiscal indicators at a time when the policy rates are going up in the US, has led dollar to appreciate in the global markets. As a matter of fact, US dollar index (DXY) that has turned its direction upwards recently, reached its peak since the beginning of 2018. In this conjuncture, US economic policy has implications on not only the dollar but also Libor rates.

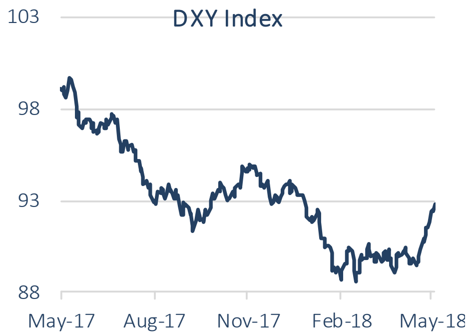
Growth in the Euro Area has lost pace.

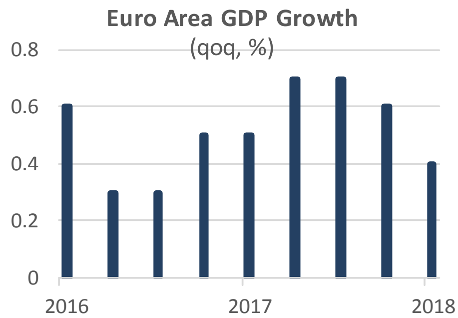
In the first quarter of 2018, Euro Area GDP growth came in at 0.4% and pictured a weak outlook. Thus, economic activity in the region posted its lowest growth for the last 6 quarters. This slowdown in the economic activity actually stemmed from one-time negative shocks such as bad weather conditions and strikes. The expectations on a more cautious monetary policy stance from the ECB in case of acceleration in the downside risks regarding future growth, led euro to depreciate. In this regard, euro/dollar parity fell below 1.20 at last week's closing.

Weak performance in domestic manufacturing industry...

Purchasing Managers Index (PMI), an important leading indicator of the manufacturing industries' performance, began the second quarter of the year with a weak performance. Having declined to 48.9 in April the index indicated a slowdown

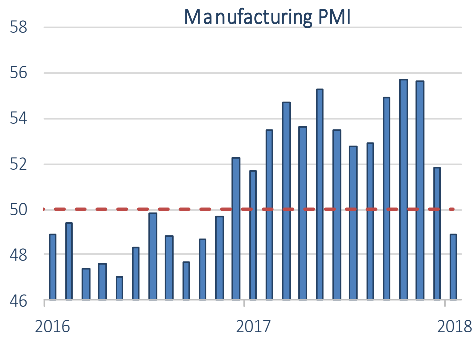






Source: Datastream

in the sector after 14 months. Deterioration in domestic orders and employment conditions was an important factor in the fall of the index, while inflationary pressures on the production side increased due to the depreciation of TRY.

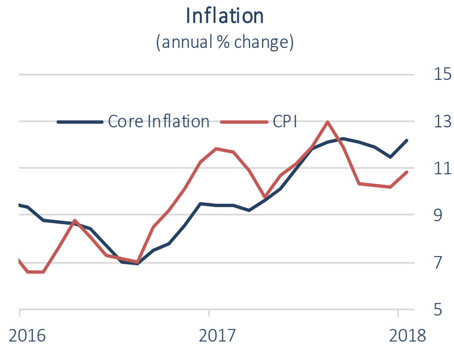


S&P cut Turkey's credit rating.

International credit rating agency S&P cut Turkey's credit rating one notch, citing the deterioration in inflation outlook and increasing volatility of TRY as reasons for its decision. Thus, Turkey's FX credit rating became "BB-", 3 notch below the investment grade. S&P stated that the step taken by CBRT in April would not be sufficient to control inflation. The agency also added that the private sector's high indebtedness increased fragility and there is a "hard landing" risk for the overheated Turkish economy.

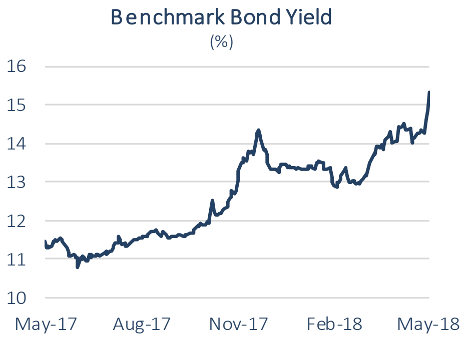
CPI rose above expectations.

In April, CPI and D-PPI surged up by 1.87% and 2.6%, respectively, well above expectations. Thus, the downward trend in annual inflation since the beginning of 2018 came to an end in April. Annual CPI inflation was realized as 10.85% in April, being the highest level of this year. In this period, rise in clothing and footwear due to seasonal factors and price developments in transportation group stood out in the rapid rise in CPI. As a matter of fact, 1.28 pp of CPI increase came from the price developments in these two groups. On the other hand, the deterioration in core inflation indicators became more evident. The depreciation of TRY which affects general pricing behaviour negatively causes uncertainties in the inflation outlook (Our Inflation Report).



Domestic financial markets…

Last week, S&P's downgrade decision and inflation data had a negative impact on domestic financial markets. Due to the deterioration in risk appetite, demand for TRY denominated assets weakened. Following a sharp decline on Monday, the downward course of BIST-100 index continued throughout the week. The index closed the week 4.7% down. The yield curve moved up for all maturities. The compound interest rate of the benchmark bond increased by 1 point wow and reached 15.36%, the highest level since the global crisis. TRY fell to a historic low. On the last trading day of the week, there were sales for profit realizations after USD/TRY tested the level of 4.29. The sales gained speed following the announcement of US non-farm payrolls data. On a weekly basis, USD/TRY increased by 4.5%, while EUR/TRY rose by 3.1% thus closing the week at 4.22 and 5.06, respectively. In response to the rapid depreciation of TRY, on May 7th, CBRT decided to lower the upper limit for the FX maintenance facility within the reserve options mechanism from 55% to 45% and redetermine the tranches. The Bank announced that approximately 6.4 billion TRY of liquidity will be withdrawn from the market and approximately 2.2 billion USD of liquidity will be provided to banks with this revision.



In the global markets, there is no significant data release this week. The effects of the recent volatility in the financial markets will be monitored closely.

Data Releases

		Period	Consensus	Prior
8 May	Germany Industrial Production	March	0.8%	-1.6%
9 May	Treasury's Domestic Debt Redemption (70 million TRY)			
	US PPI (mom)	April	0.3%	0.3%
10 May	BoE Meeting			
	US CPI (mom)	April	0.3%	-0.1%
	US Jobless Claims	April IV	220k	211k

Source: Datastream

Sectoral Developments

New incentives for the housing sector...

While the house sales declined by 6.7% in the first quarter of 2018, recent measures taken to ease the demand side congestion are closely monitored. The Ministry of Finance has announced that the tax on the real estate sales has been reduced for the next 6 months. In this context, the rate of VAT on house sales is reduced from 18% to 8% until October 31st. Besides, the rate of title fees is also reduced from 4% to 3%.

Slowdown in automotive sales...

The increase in car prices gained momentum recently and put pressure on domestic demand. As of April 2018 automobile prices increased by 26.7% yoy, mainly due to the depreciation in TRY. In the same period domestic automobile sales declined by 5%, while light commercial vehicle sales narrowed by 11%.

The retail sector continues to enhance its overseas presence.

According to the announcement made by the United Brands Association, the number of Turkish stores abroad, which was 3,150 in 2017, will continue to grow this year and is expected to reach 4,000 units. It is said that the interest towards Turkish brands is quite strong, while the supports given under the Turquality scheme contributes to the competitiveness of the retail sector in foreign markets. The Turkish retail sector has made significant progress in the Balkan countries and North Africa, while Russia and Ukraine are the target markets for the coming period.

Economic Research Division

İzlem Erdem Chief Economist izlem.erdem@isbank.com.tr	Dilek Sarsın Kaya Asst. Manager dilek.kaya@isbank.com.tr
Alper Gürler Unit Manager alper.gurler@isbank.com.tr	Bora Çevik Economist bora.cevik@isbank.com.tr

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