Erste Group Research
Week ahead | Macro, Fixed Income | Eurozone, US
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Week ahead

Turkey crisis – between hysteria and facts
EZ – will the industry sentiment climb further in August?

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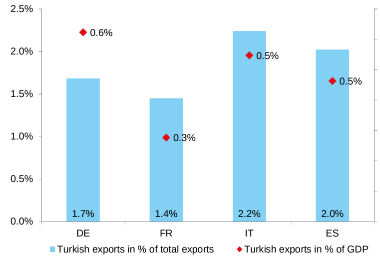
Exports EZ-countries to Turkey



Source: trademap.org, Erste Group Research

Lasting global implications from lira drop seem unlikely

Following a massive decline that reached its peak to date at the beginning of the week, the Turkish lira's exchange rate levelled off, meaning that the losses could be compensated for partially. The deterioration of the lira had global implications and affected almost all segments of financial markets. We will discuss here whether these reactions were justified.

Based on trade data, Turkey plays only a very subordinate role in the economy of the Eurozone. For example, exports from Germany to Turkey amounted to about 0.6% of German economic output in 2017. Furthermore, the low share of exports from the most important countries of the Eurozone to Turkey dropped continually in 2016 and 2017. This means that Turkey has already lost importance as a trading partner for the Eurozone. Based on the trade data, we therefore do not expect dampening effects on the growth of the Eurozone resulting from the current crisis in Turkey.

The financial market's worries mainly concerned the global implications of a crash of the Turkish lira. A deterioration of the exchange rate puts more and more borrowers of foreign currency loans in Turkey under pressure, potentially triggering higher loan write-offs for Turkish banks. Due to the existing interconnections (see below) this might eventually create difficulties even for European banks. This risk was even higher, as the lira looked to be in free fall.

From our perspective, there are two aspects that need to be taken into account when assessing the lira risks: on the one hand, relatively short-term factors, which have an impact on investor's readiness to finance Turkish external debt. These factors include the interest rate level in Turkey, but also in the US, as well as political topics like the dispute surrounding the US pastor interned in Turkey. These aspects depend on political decisions and are accordingly difficult to predict. A parameter for the mid-term potential of the Turkish lira is a fundamental factor like the real effective exchange rate and this should also should be considered. This index shows the development of the lira vs. a trade-weighted basket of currencies adjusted by the inflation differential. A decreasing index, as in previous years, means that the nominal exchange rate has weakened more than the inflation differential. This results in an improvement of the competitive situation of the Turkish economy because the exchange rate has weakened more than domestic inflation (costs) has risen. Thus some Turkish companies benefit from a weaker exchange rate while others, those currently the focus of the markets, suffer from it. For companies with a foreign currency loan, the depreciation of the exchange rate means an increase in their indebtedness. As long as the exchange rate weakening remains below the Turkish inflation rate plus real economic growth, this should be manageable for Turkish companies. In this case, the revenues of the companies rise faster on average than their indebtedness. In the

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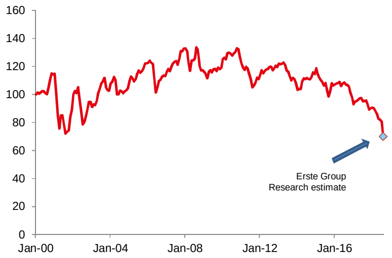
Real Effective Exchange Rate of the Turkish Lira, Index



Source: BIS, Erste Group Research

other case – as it is now – the pressure on the companies is growing. Hence the extent of the weakening is so important and consequently the rapid fall of the currency created disturbances on the markets. Turkish companies have increasingly financed themselves in foreign currency for the past few years, primarily in the US dollar and euro.

The main issue for the global capital markets was the contagion of European banks. Data provided by the Bank for International Settlements (BIS) indicate that Spanish banks have claims of more than USD 80bn against Turkey, followed by France with close to USD 40bn. Since these are consolidated figures, they include the claims of the respective subsidiary banks in Turkey against their customers, which stand at USD 47bn and USD 18bn, respectively. These claims are counterbalanced by local deposits which have to be taken into account in assessing the risk. The Italian banking sector has claims of USD 16bn. According to media reports, three banks are particularly affected in the countries mentioned. The Spanish BBVA, the French BNP Paribas and the Italian UniCredit.

It is not possible to predict how the political dispute will develop, not least due to the persons involved. The markets certainly reacted in an extremely nervous and hysterical manner to the announcement of US tariffs on aluminum and steel imports from Turkey. After the announcement that tariffs would be doubled to 20% and 50%, the lira depreciated against the dollar by 30%. As of now, the lira is weaker by “only” 6% compared to the end of last week. The lira might again come under pressure if the political situation worsens. However, the strong countermovement after the fall gives reason to hope that the markets have moved towards a differentiated view after the initial shock. As mentioned, Turkish companies should be able to handle, within limits, a continuous weakening of the lira. It is not possible to predict how much the loan write-offs in Turkey will rise because it is unclear how the positive and negative impacts of the currency weakening will play out in the end. In combination with the scope of the linkage of the Turkish banking sector with the European one, we see low potential for global implications which go beyond market volatility.

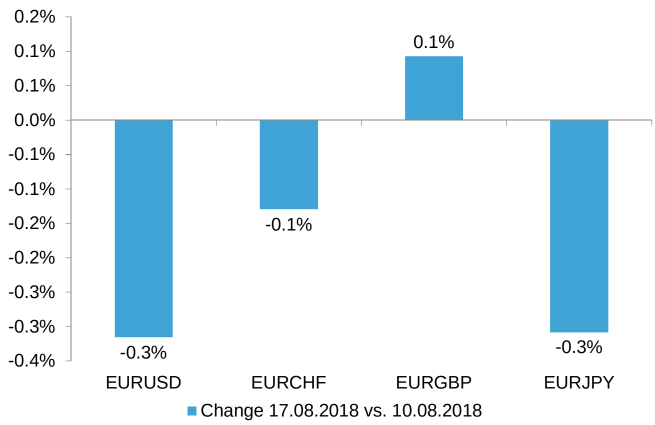
EZ - Industry sentiment should stabilize in August

The first flash estimate for the industry sentiment of the Eurozone as well as of Germany and France will be published next week (August 23). In July, sentiment rose slightly for the first time in several months. Overall, however, concerns about tariffs and a potential trade war still weighed on sentiment.

After the geopolitical environment has barely improved in August, we only expect stabilization of industry sentiment in the Eurozone. The growth momentum of the Eurozone has stabilized for the time being in 2Q18, with a GDP growth rate of +0.4% q/q. On the basis of the currently available indicators, we expect stable growth in the Eurozone in 3Q18. The decisive question for 3Q will be whether France will be able to boost growth dynamics after a disappointing first half of the year (strikes and the flu epidemic had a dampening effect). If this is attained, then Eurozone GDP growth could slightly accelerate in 3Q. Given the willingness for reform on the part of Macron’s government, we continue to be positive about the long-term growth prospects of France.

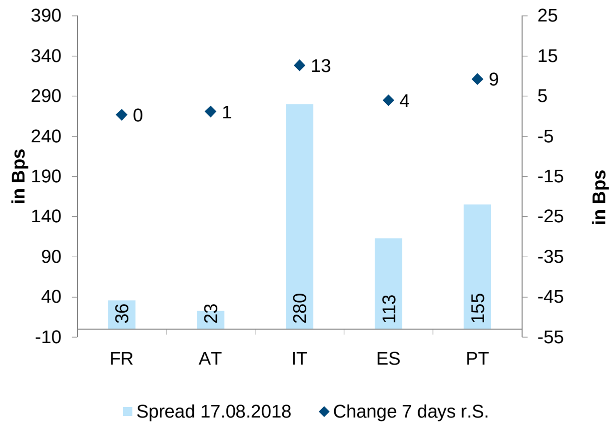
Forex and government bond markets

Exchange rates EUR: USD, CHF, GBP and JPY
change last week
(+ stronger euro / - weaker euro)



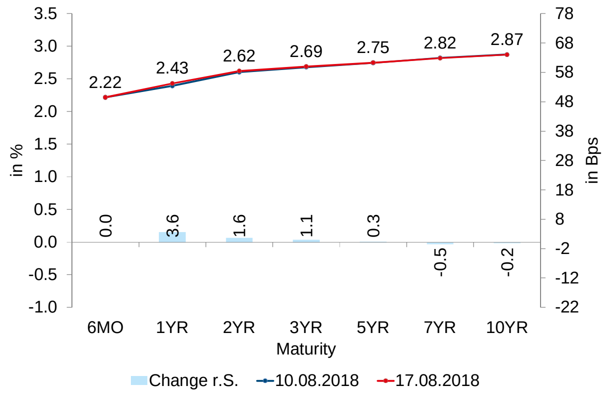
Source: Bloomberg, Erste Group Research

Eurozone – spreads vs. Germany
10Y government bonds



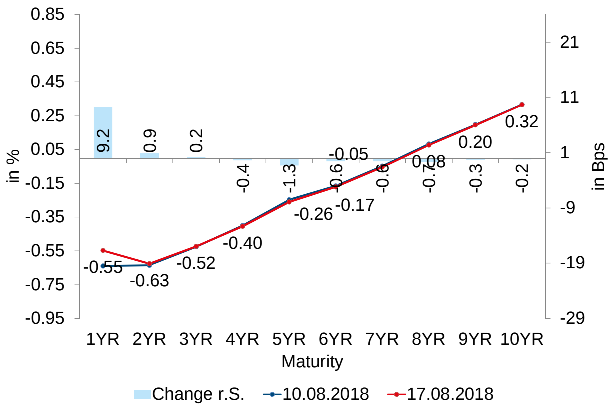
Source: Bloomberg, Erste Group Research

US Treasuries yield curve
change last week



Source: Bloomberg, Erste Group Research

DE Bund yield curve
change last week



Source: Bloomberg, Erste Group Research

Economic calendar

Date	Time	Ctry	Release	Period	Consens	Prior
17-Aug	n.a.	AT	Inflation y/y	Jul		2.3%
		AT	CPI m/m	Jul		0.1%
	10:00	IT	CA Balance (m)	Jun		2226 m
		EA	CA Balance (m)	Jun		22 m
	11:00	EA	CPI m/m	Jul	-0.3%	-0.3%
		EA	Inflation y/y	Jul F	2.1%	2.1%
	16:00	US	Univ. Michigan Index	Aug P	98.1 index	97.9 index
20-Aug	8:00	DE	PPI y/y	Jul	1.6%	3.0%
22-Aug	16:00	US	Existing Home Sales	Jul	5.4 m	5.4 m
23-Aug	9:00	FR	PMI Manufacturing	Aug P		53.3 index
	9:30	DE	PMI Manufacturing	Aug P	56.7 index	56.9 index
	10:00	EA	PMI Manufacturing	Aug P	55.2 index	55.1 index
	14:30	US	Jobless Claims	-	215.4 thd	212.0 thd
	16:00	US	New Home Sales	Jul	647.4 thd	631.0 thd
		EA	Consumer Conf.	Aug A	-0.6 index	-0.6 index
24-Aug	8:00	DE	GDP q/q	2Q F	0.5%	0.5%
		DE	GDP y/y	2Q F	2.0%	2.0%
	9:00	AT	Ind. Prod. y/y	Jun		6.2%
	14:30	US	Durable Goods Orders	Jul P	0.5%	0.8%

Source: Bloomberg, Erste Group Research

FORECASTS[1])

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.4	2.3	2.2
US	2.9	1.5	2.3	2.8	2.2

Inflation	2015	2016	2017	2018	2019
Eurozone	0.1	0.2	1.5	1.7	1.7
US	0.1	1.2	2.2	2.2	1.9

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.32	-0.30	-0.30	-0.30	-0.30
Germany Govt. 10Y	0.30	0.60	0.70	0.90	1.00
Swap 10Y	0.87	0.90	1.00	1.20	1.30

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
Fed Funds Target Rate*	1.91	2.13	2.38	2.63	2.88
3M Libor	2.31	2.40	2.70	2.90	3.20
US Govt. 10Y	2.85	3.20	3.30	3.50	3.50
EURUSD	1.14	1.14	1.13	1.15	1.16

*Mid of target range

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
Austria 10Y	0.53	0.80	0.90	1.10	1.20
Spread AT - DE	0.23	0.20	0.20	0.20	0.20

In case of changes to our forecasts compared to the previous issue, arrows show the direction of the change.

Source: Bloomberg, Erste Group Research

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

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