



Economics Group

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Turkish Q3 GDP Disappoints

Data released this morning revealed that Turkey's economy contracted 1.8 percent on a year-over-year basis. The broad-based weakness seen in domestic demand can likely be traced to the military coup last July.

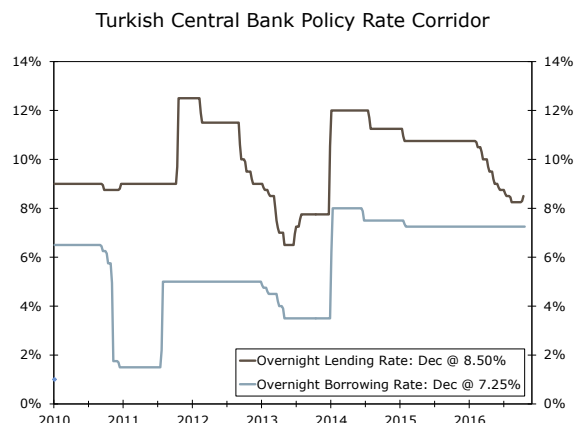
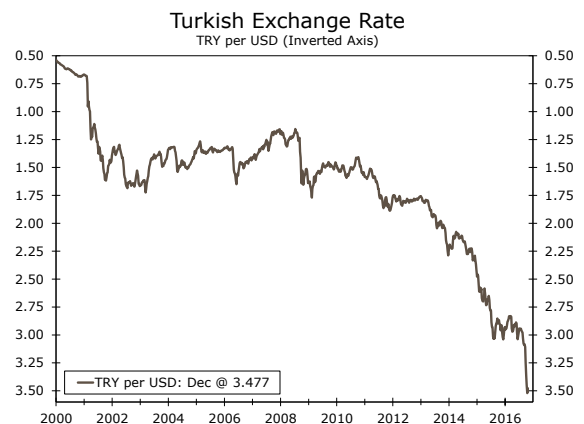
Political and Economic Distress

Turkish GDP decreased 1.8 percent in Q3 on a year-ago basis, widely missing the consensus forecast that called for modest growth of 0.3 percent. The broad-based weakness across the GDP domestic demand and components is consistent with the uncertainty and general sense of disorder in the economy in the wake of the military coup this past July. For instance, household spending contracted 3.2 percent on a year-over-year basis, an indication that consumers may have been hesitant to spend in the midst of such political uncertainty. The previous six quarters of household spending all experienced positive year-over-year growth and expanded at an average pace of 4.4 percent. Gross fixed investment also contracted, dipping 0.6 percent from a year ago.

Furthermore, exports of goods and services declined a substantial 7.0 percent from a year ago, a further indication that the attempted coup disrupted economic growth in the third quarter. Likewise, imports of goods and services slowed sharply, expanding only 4.3 percent on the heels of a 9.1 percent expansion in the second quarter. The recent firming of oil prices is certainly a headwind given Turkey's significant oil imports. The only GDP component which impressed to the upside was government consumption, increasing 23.8 percent on a year-over-year basis. While it is difficult to prove a direct causal link between the attempted military coup and the economic slowdown in the third quarter, especially with the limited data available, political turmoil in Turkey could continue to raise doubts over growth stability.

Currency Woes

In the wake of the military coup and the subsequent political volatility, the Turkish lira has, not surprisingly, weakened. In fact, since July 15, the date of the coup, the lira has depreciated roughly 20 percent against the dollar. However, among emerging currencies, the lira is only notable in the magnitude of its weakness, as during this period most emerging currencies have been hammered against the backdrop of rising U.S. interest rates. In response to the heavy lira sell-off, the Turkish central bank recently raised its overnight lending rate (the ceiling of its policy rate corridor) in an attempt to stabilize its currency. The recent rate hike diverts from the central bank's pattern of rate cuts since mid-2014. The central bank may hike rates further to prevent additional lira weakness. CPI inflation, which has recently been stable, will likely trend higher, at least in the near term, due to currency depreciation. Our currency strategy team expects the lira to be among the more vulnerable emerging currencies moving forward. A sizeable current account deficit along with eventual Fed tightening suggest potential for further lira downside.



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