Eurobank Research
www.eurobank.gr/research
research@eurobank.gr

NEW EUROPE
ECONOMICS & STRATEGY

Eurobank EFG

December 10, 2010

FOCUS NOTES: TURKEY

Written By:

Galatia Phoka
Emerging Markets Analyst
gphoka@eurobank.gr

Real GDP slows more than expected in Q3, exposing unbalanced growth dynamics

Turkey's real GDP growth slowed to 5.5%yoy in Q3, after expanding by 11.0%yoy in H1:2010. This was the first disappointing GDP reading after several quarters of upside surprises, coming as a result of waning base effects, a slowdown in the pace of inventory adjustment and a widened external imbalance. Note that the market's median forecast was for a 6.6%yoy reading. The favorable impact of the rebuilding of inventories is gradually diminishing, with the change in stocks subtracting 0.4ppts from growth in Q3, halting a positive contribution trend over the prior four quarters. Meanwhile, government spending fell by 1.1%yoy in Q3 (+2.2%yoy in H1) slashing off 0.1ppts from GDP growth, reflecting strengthening fiscal consolidation. However, a major drag came from net trade, which took away 4.6ppts as exports fell by 2%yoy (+5.7%yoy in H1) after expanding by nearly 12%yoy a quarter earlier. On the other hand, imports' growth remained robust at 16.9%yoy (+20.4%yoy in January-June) in view of robust domestic demand. In support of the latter, overall domestic demand contributed ca 10.1ppts to Q3 growth as private consumption jumped 7.6%yoy (+7.3%yoy in H1) adding 5.1ppts. Moreover, investments soared by 31.3%yoy (+22.3%yoy in H1), recording their highest rate of increase since 2004 and providing 5.5pts to the overall GDP growth. Calendar adjusted real gross domestic product grew by 6.4%yoy, while on a quarter-on-quarter basis seasonally and calendar adjusted GDP rose by 1.1%.

In spite of the Q3 GDP slowdown, Turkey continues leading the economic recovery in New Europe, with full-year growth forecasted at 7.5%yoy. Domestic demand will likely remain the primary driver of growth in the quarters ahead in view of the rapid credit expansion and gradually improving labour market conditions. On the flipside, net exports are seen remaining a drag to growth as the domestic economic recovery outpaces that of Turkey's main trade partners. For 2011, we continue to anticipate a slowdown to 5.0%, on back of unfavorable base effects and an increasingly negative contribution from net exports.

Furthermore, we continue to expect that the CBT will stay put on rates in the coming months and expect the inception of its monetary tightening cycle not earlier than in Q4 2011. In support of our view, underlying inflation pressures appear contained (with the latest core CPI indices remaining near record low levels) and the rise witnessed in headline inflation during the August-October period being primary driven by cost-push rather than demand-pull factors. Moreover, a rate hike any time soon is likely to add to the recent surge in capital inflows, which has exerted appreciation pressures on the lira, stirring concerns about a slower recovery in exports and exacerbating the country's rising external vulnerabilities.

Economic Research & Forecasting Division

Editor

Prof. Gikas Hardouvelis:
Ch ief Economis t & Director of Research Eurobank EFG Group

Research Team

Dimitris Malliaropoulos: *Economic Research Advisor*
Platon Monokroussos: *Head of Financial Markets Research Division*
Tasos Anastasatos: *Senior Economist*
Ioannis Gkionis: *Research Economist*
Stella Kanellopoulou: *Research Economist*
Olga Kosma: *Economic Analyst*
Theodosios Sampaniotis: *Senior Economic Analyst*
Theodoros Stamatiou: *Research Economist*
Paraskevi Petropoulou: *G10 Markets Analyst*
Maria Prandeka: *Economic Analyst*
Galatia Phoka: *Emerging Markets Analyst*
Vassilis Zarkos: *Junior Economic Analyst*

Eurobank EFG, 20 Amalias Av & 5 Souri Str, 10557 Athens, tel: +30.210.333 .7365, fax: +30.210.333.7687,
web: http://www.eurobank.gr/research , contact email: Research@eurobank.gr