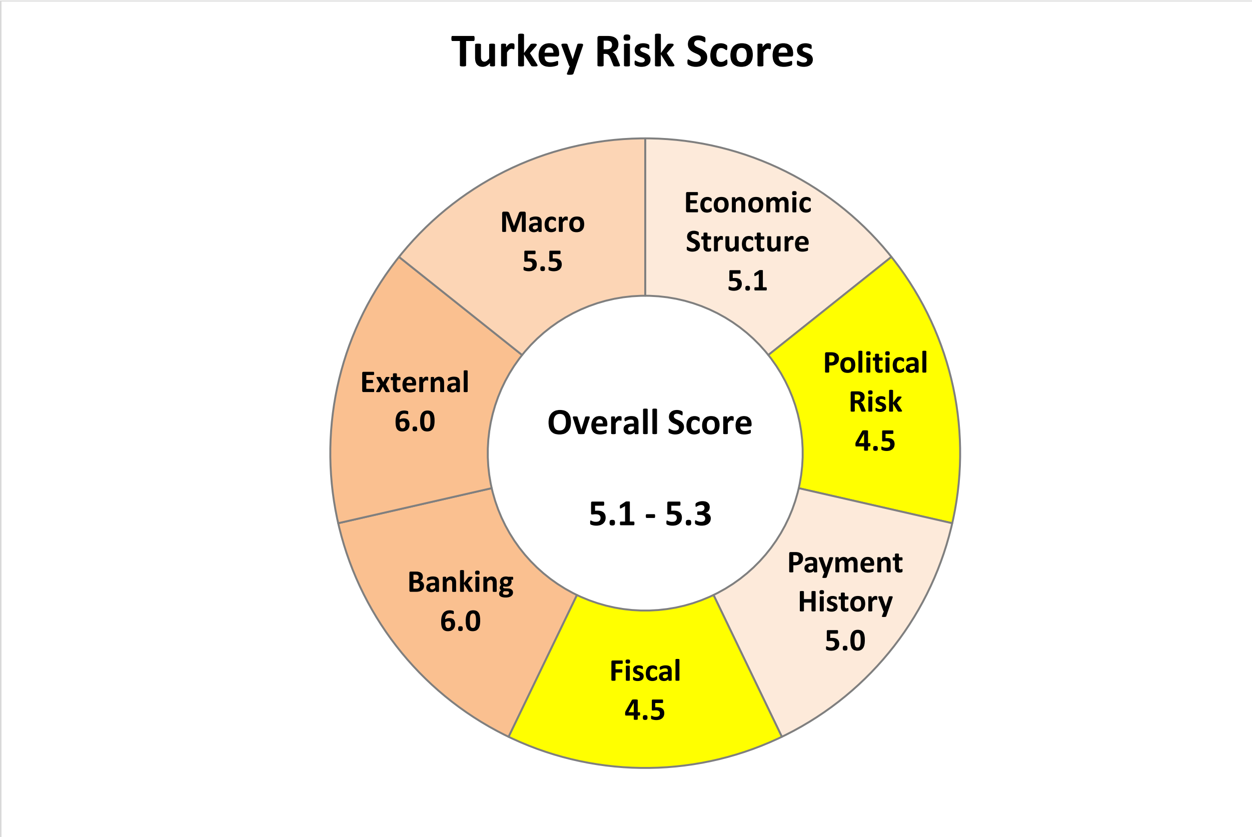

Turkey Trend Risks

The Turkish economy has sustained growth rates well above most emerging market countries. Real GDP increased 3.6% p.a. over the past four years, and is expected to rise by 3% in 2017. Large minimum wage hikes and lower oil prices accounted for much of this, along with readily available consumer credit. These pressures lifted prices by 9% in 2016, and will continue to feed through the economy in 2017.

Low domestic savings and strong demand have resulted in large trade and current account deficits. The 2016 current account deficit at 4% of GDP is troubling. But more critically, Turkey relies heavily on foreign borrowing (now in excess of 50% of GDP) to fund this; half must be rolled over each year. In the same vein, Turkey's fiscal deficit at 2-3% of GDP is not excessive; but Turkey relies on foreign creditors for more than a third of public funding, leaving it vulnerable to sudden shocks from home or abroad.

The government recognizes the need for structural reforms to boost savings through higher retirement ages and greater productivity through labor market reforms and skills training. The banking system also requires attention, as liquidity and deposit to loan ratios are far below BIS / IMF preferred levels.

President Erdogan weathered a military coup attempt in September. He used the event as a rationale for sweeping military dismissals and much tighter civil rights restrictions. This occurs against the backdrop of a huge influx of Syrian refugees and ongoing border wars, keeping tensions very high.