

DenizBank Economic Update

August 2017

- **Economy**
- **Financial Markets**
- **Banking Sector**

Economic Research and Strategy

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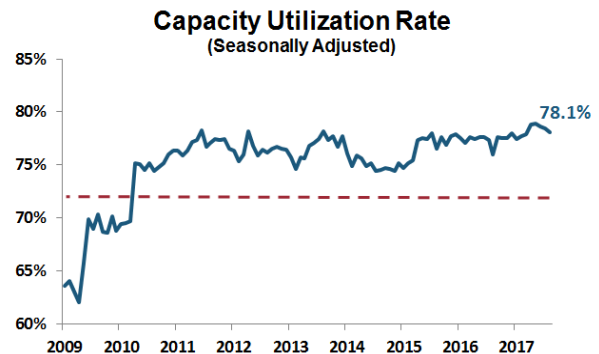
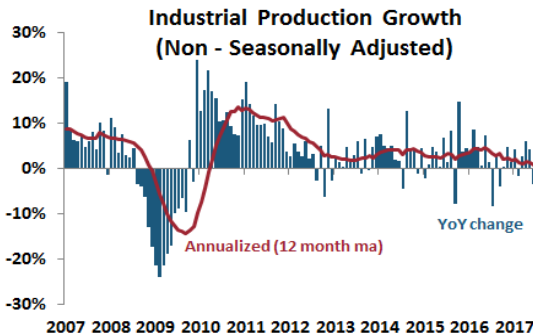
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DenizBank Economic Update

Economy (I)

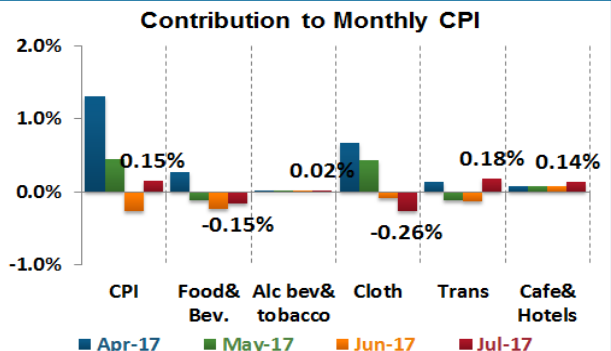
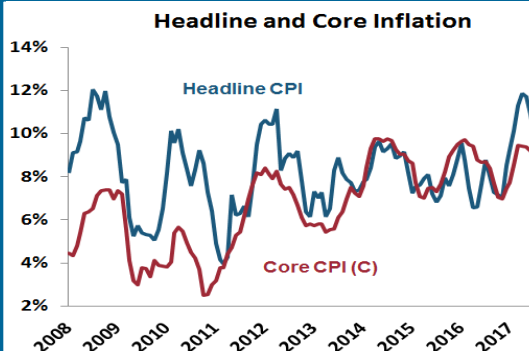
Growth



Despite a temporary slowdown in June, economic activity remains solid in Q2 and early Q3...

- Seasonally and calendar adjusted industrial production (IP) index contracted MoM by 0.4% in June. The unadjusted index declined 3.6% annually. With June data, IP index rose 2.1% in the second quarter compared to a year ago, indicating GDP growth could be stronger than first quarter.
- Early indicators signal expansion in economic activity continues in third quarter. Manufacturing PMI decreased slightly from its 3 year peak in June to 53.6 in July. However, the index still remains above 50 threshold for 5 consecutive months, indicating economic activity in manufacturing sector is expanding.
- Domestic demand's contribution is expected to remain high as solid growth in total loans continue throughout 3Q17. The pick up in economic activity following 3Q16 was mostly driven by government's incentives and tax cuts. With government incentives receding by 4Q17, GDP growth rate may slowdown towards the end of this year. However, 2017 full year growth is expected to exceed 4%, meaning Turkey would remain one of the fastest growing countries among its peers.

Inflation



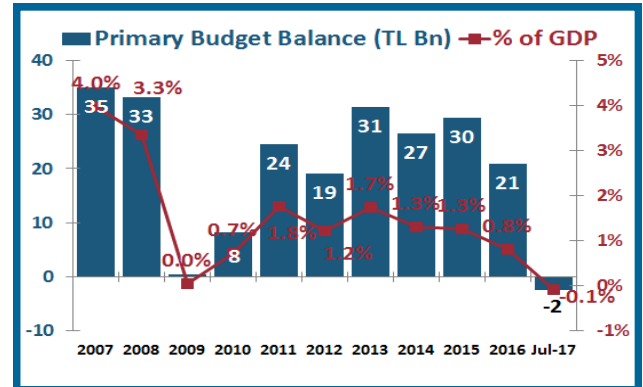
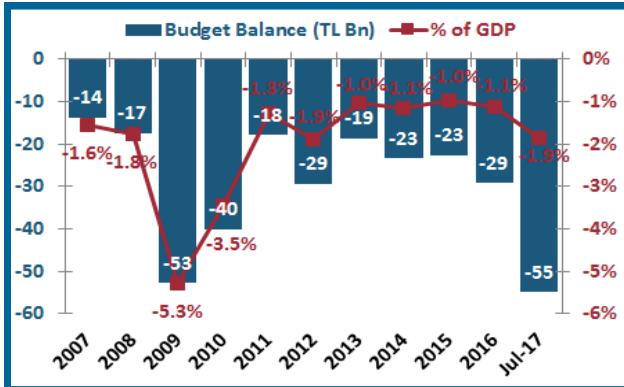
Inflation is back to single digits, though probably not permanently...

- CPI in July increased MoM by 0.15%, in line with the market expectation. Food prices decreased by 0.7%, making this the third month of a consecutive decline.
- Annual inflation dropped to 9.8% from 10.9% a month ago. Annual food inflation went down to 10% from 14% a month ago. Core CPI on the other hand (CPI excluding food, energy, non-alcoholic and alcoholic beverages, tobacco, gold) increased to 9.6% from 9.2%. Producers' price index increased YoY by 14.9%.
- There was little reason to celebrate inflation's fall to single digits in July as core inflation spiked and expectations for the coming three months suggest that headline inflation may start to increase again. The downward trend in TRY volatility since mid May has contributed to the decrease in inflation. However, the spike in core inflation may be caused by the short lived jump in volatility in early July, indicating how sensitive price behavior is to movements in currency. From December on, favorable base effect is expected to come into play and barring an external shock, inflation may start a sustainable downward trend into 2018.

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Economy (II)

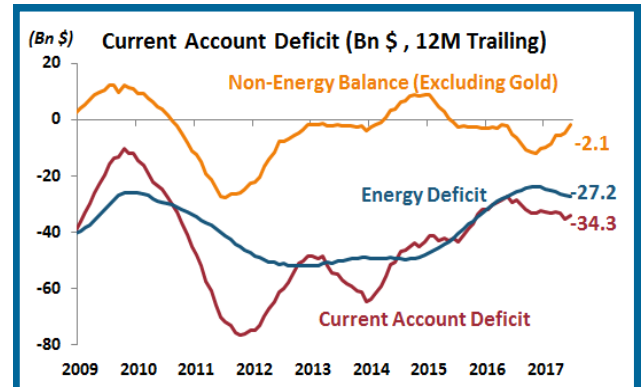
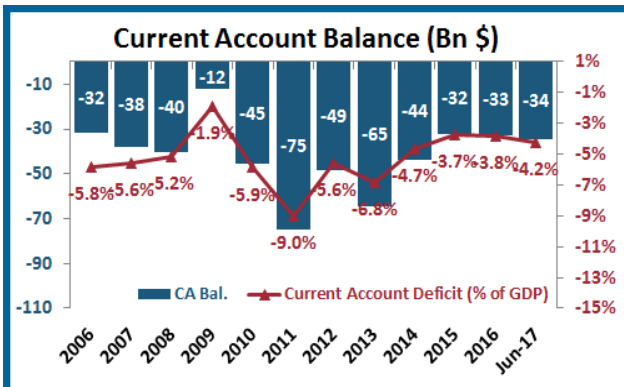
Fiscal Policy



Fiscal expansion continues in the first seven months of 2017...

- Central government budget produced a small monthly surplus in July, thanks to an increase in tax revenues. 12 month cumulative deficit declined slightly to TL 54.8 bn from TL 55.6 bn. 12 month cumulative primary balance, which caused a deficit for the first time in June since 2009, again ran a deficit of TRY 2.4 bn.
- In the first seven months of the year, budget revenues increased 11% over a year ago. Tax revenues were up by 16%, while non-tax revenues fell by 8%. This was partly caused by the government's decision to delay social security premium collection to the last quarter of the year in order to boost employment.
- As economic data shows, tax cuts and other incentives have provided boost to economic activity. While this has taken a toll on fiscal performance so far throughout the year, officials have signalled that fiscal expansion will subside in the last quarter of the year.

External Sector



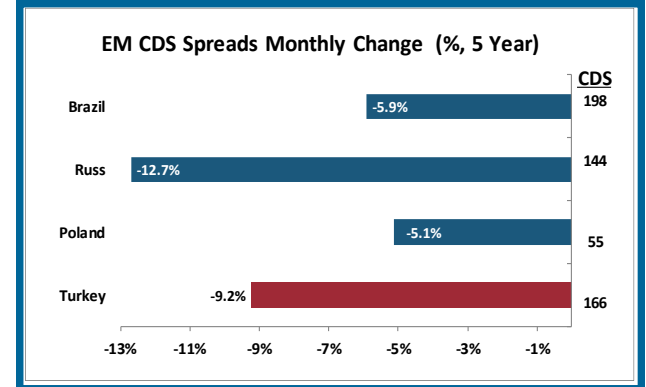
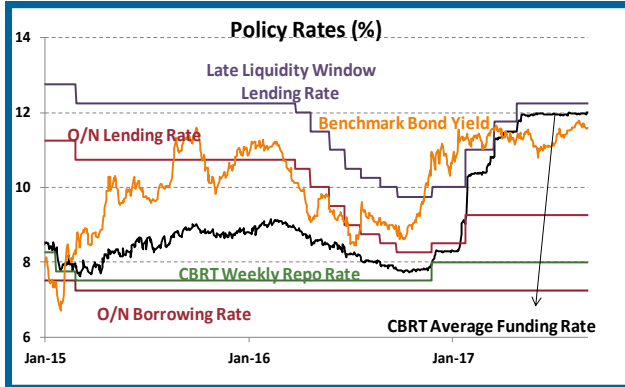
Current account deficit has shrunk in June, as non-gold and non-energy (core) balance continues to improve..

- Current account deficit (CAD) in June came in line with expectations at \$3.8 bn. 12 month cumulative CAD decreased to \$34.3 bn from \$35.5 bn in May (June 2016: \$29.3 bn).
- Financing of the deficit continued to come primarily from portfolio inflows. Net portfolio inflow in was \$4.2 bn. Portfolio inflows in the first half of the year posted a 108% increase to \$17.4bn. Annualized tourism revenues increased slightly to \$14.6bn from \$14.2bn.
- Annualized core deficit narrowed to \$2.1bn in June from \$5bn from a month ago. Annualized net gold imports were \$5.1 bn.
- Annualized CAD which stood at \$32.6bn at the end of 2016 widened merely \$1.7bn in the first half of 2017. During a period of economic expansion and rapid credit growth, CAD which is highly correlated to these indicators have been persistent. In the remainder of the year, CAD may widen slightly further, however remain at a sustainable level, namely below 5% of GDP.

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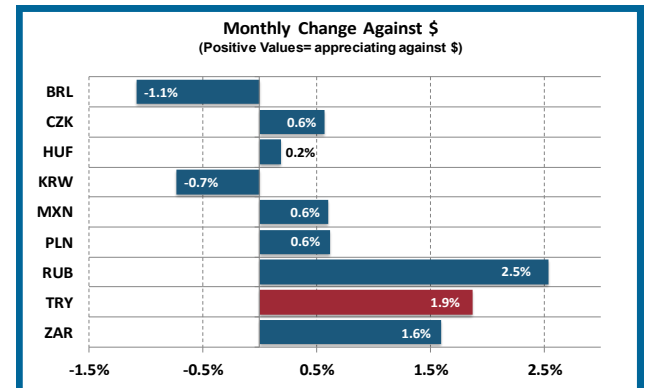
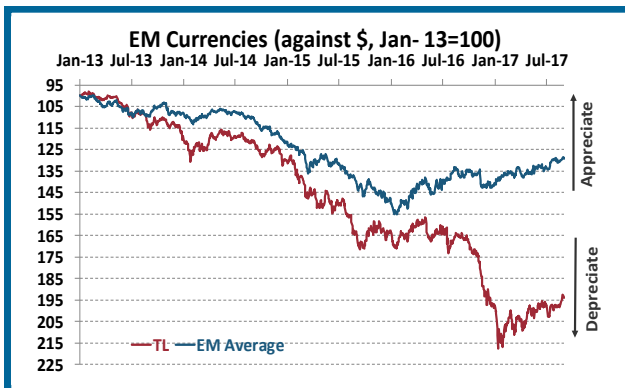
Financial Markets

Debt Market



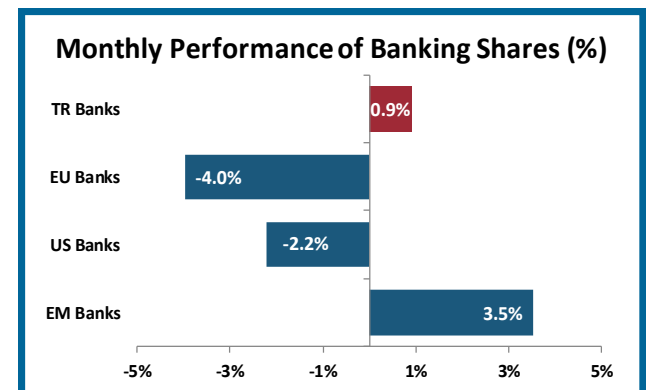
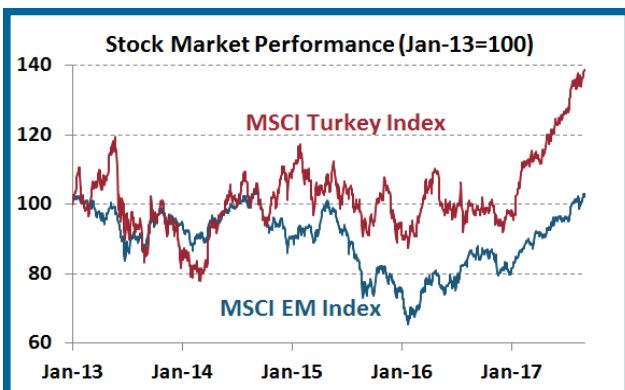
2-year benchmark bond yield is at 11.59%.

Currency Market



Turkish Lira was among the top performers in EM currencies against USD in August.

Stock Market

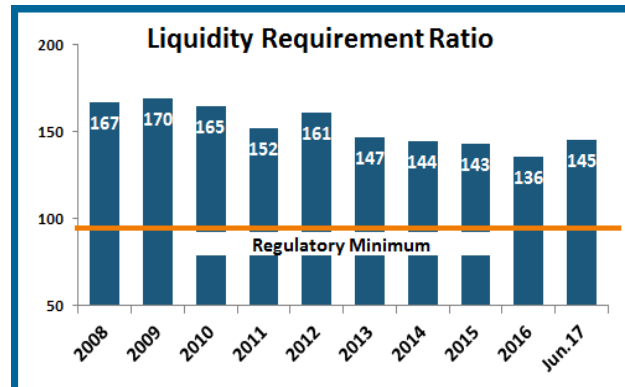
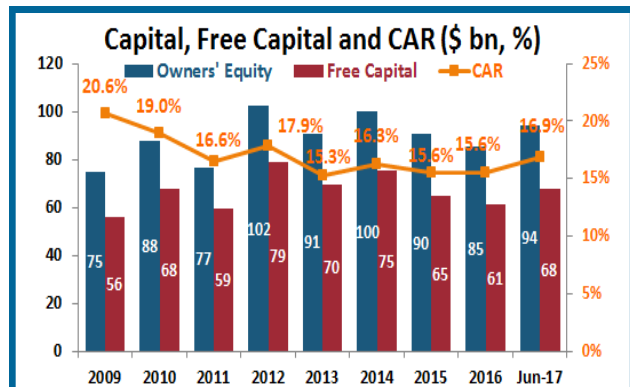


Positive performance in EM equity markets continued in August.

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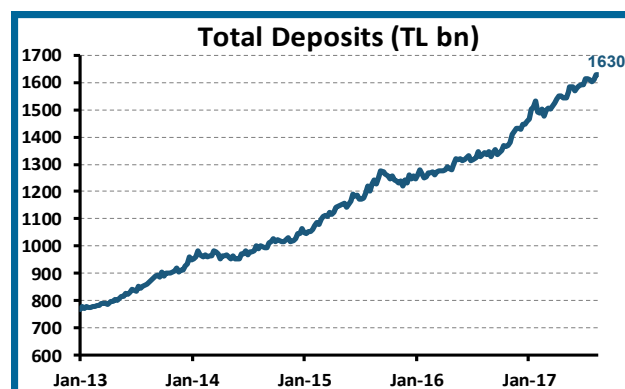
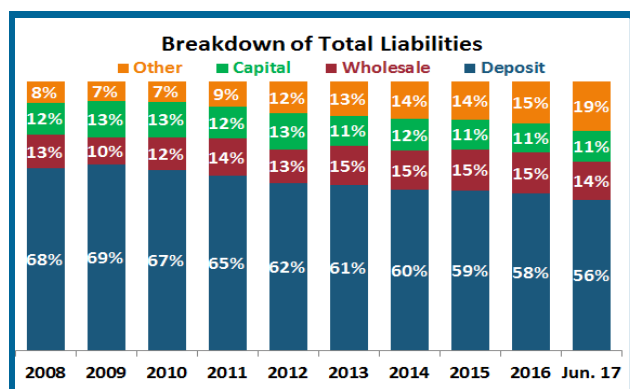
Banking Sector (I)

Capital



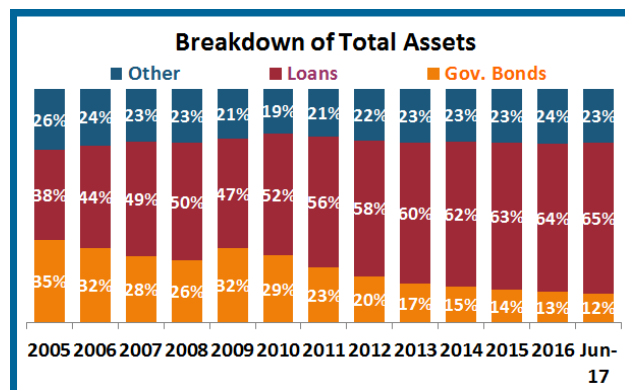
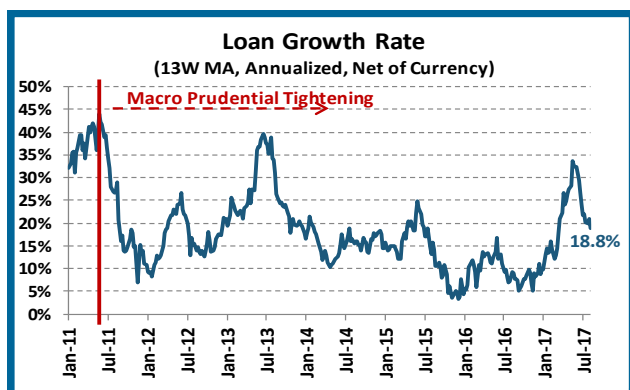
CAR increased to 16.9% in Jun 2017.

Funding



Share of deposits in funding was at 56% as of Jun 2017.

Lending

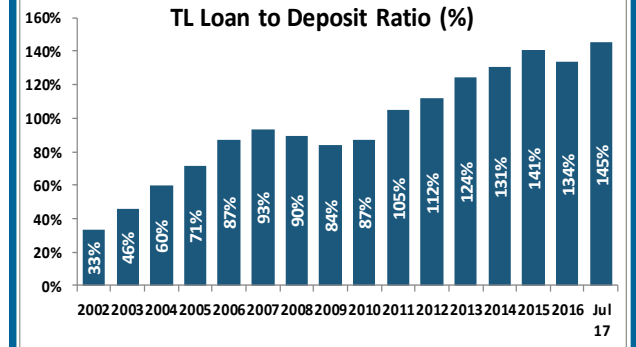
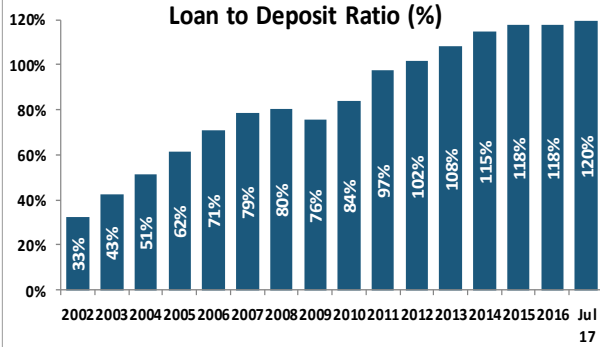


Annualized loan growth is at 18.8% as of Aug 18th.

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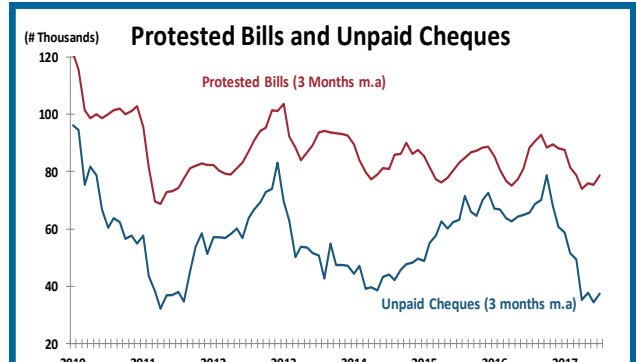
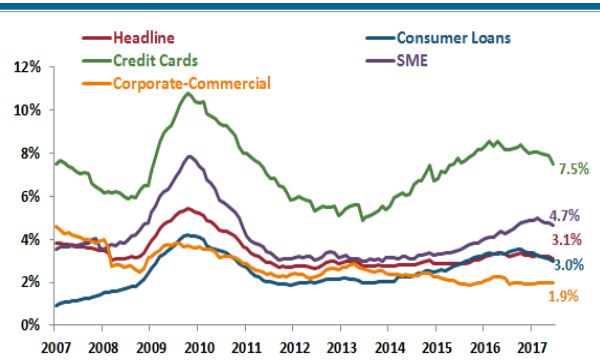
Banking Sector (II)

Loan to Deposit Ratios



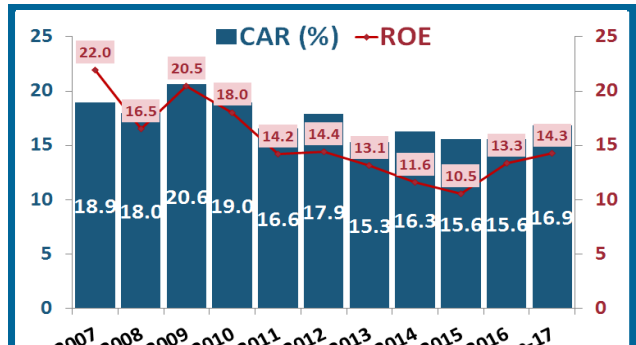
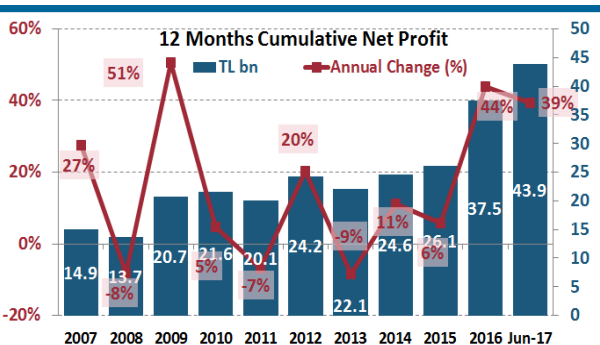
Loan to deposit ratio is 120% in July.

Loan Quality



Headline NPL ratio for the sector is at 3.1% as of Jun 2017.

P & L



In Jun 2017, banking sector's annual profit increased YoY by 39% while ROE is 14.3%.