

DenizBank Economic Update

January 2018

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

Economic Research and Strategy

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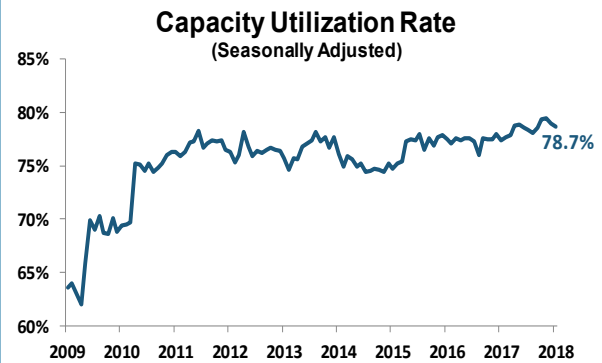
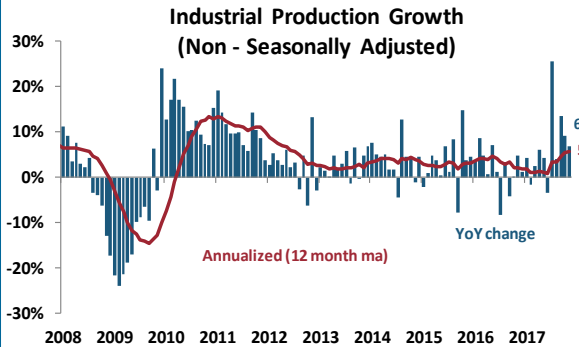
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DenizBank Economic Update

Economy (I)

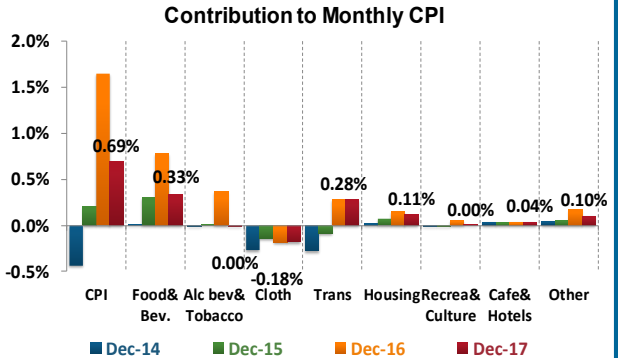
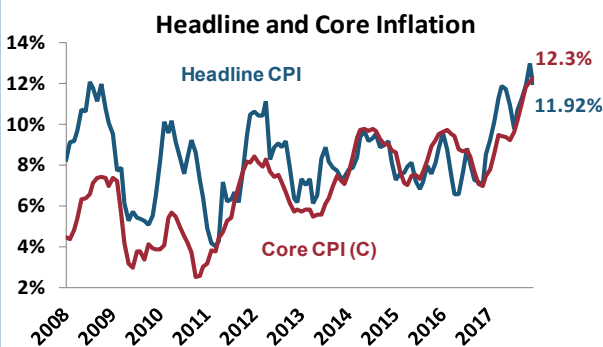
Growth



Growth remained strong in the fourth quarter of 2017...

- Following a 11.1% surge in GDP in 3Q17, leading indicators suggest that growth performance remained strong in 4Q17. In the first two months of 4Q17, the unadjusted IP index was up 8%, lower than 3Q17 (13.7%), but still well above 1H17 (1.9%). Moreover, manufacturing PMI rose to 54.9 in December, close to its highest levels since 2011, and well above the long term average of 50.8.
- Early indicators signal that economic activity remains positive at the beginning of 2018, as well. Capacity utilization in January was at 78.7%, close to 2017 average of 78.5%. Real sector confidence index was strong at 110.9, with increased investment spending and export order expectations.
- Industrial production and other preliminary indicators show that economic activity remained strong in 4Q17. Nevertheless, the surge in imports signals that the contribution of net exports may turn to negative. Also as fiscal incentives expired and credit stimulus reached its 2017 limits by 4Q17, we expect growth to be somewhat moderate in 4Q17, but 2017 overall growth rate to be strong at 6.5%. In 2018, with credit guarantee facility loans declining significantly compared to 2017, we expect growth to lose some momentum. Risks to government's 5% growth target are tilted to the downside.

Inflation



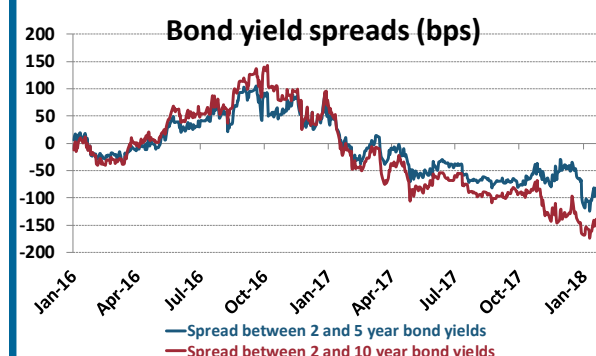
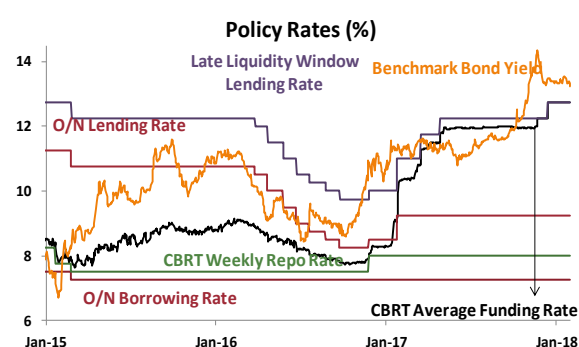
Inflation started a downward trend thanks to favorable base effect...

- In December, CPI increased MoM by 0.69%, in line with the market expectations. December CPI was mainly driven by sharp increases in food and transportation prices. Food prices increased MoM by 1.52% contributing 0.33 pp to the monthly CPI. Transportation prices increased by 1.69% contributing 0.28 pp to the CPI as motor vehicle prices rose due to weaker TL.
- As favorable base effect kicked in, annual inflation decreased to 11.9% in December from the 13% peak in November. Core inflation (CPI excluding food, energy, non-alcoholic and alcoholic beverages, tobacco, gold) on the other hand continued its upward trend, rising to 12.3%, its highest level since 2004. Annual producers' price inflation remains elevated at 15.5%.
- Thanks to the favorable base effect and waning impact of exchange rate depreciation, we expect inflation to be on a downward trend in the first four months of 2018. However, given the continued cost pressures and the elevated levels of core inflation and producer prices, we expect a limited and transient downward movement. We expect annual inflation to remain at double digits most of the year in 2018 and to be 9.5% at the year-end.

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Economy (II)

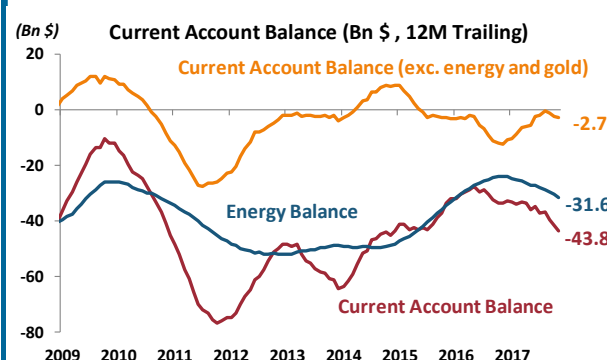
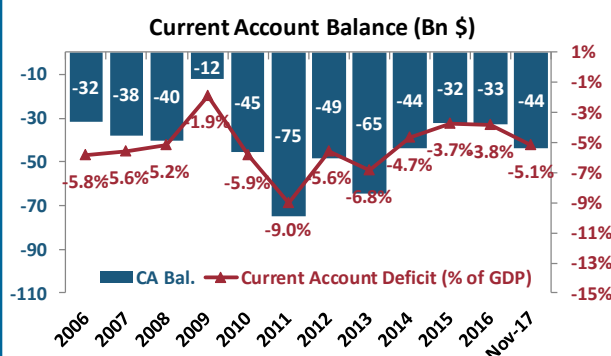
Monetary Policy



Central Bank of Turkey stresses commitment to a tight monetary policy stance until inflation outlook improves significantly...

- In January meeting, as expected, Central Bank (CB) kept policy (8%), O/N lending (9.25%) and O/N borrowing (7.25%) and most importantly late liquidity window (12.75%) rates unchanged. CB continued to provide all funding through late liquidity window and the average funding rate remained at 12.75%.
- Decision statement was marginally more hawkish with the emphasis on high inflation expectations and persistently tight policy stance. CB reiterated that monetary policy will be maintained tight decisively until the inflation outlook displays a significant improvement independent of base effects and temporary factors, and becomes consistent with the targets. CB stands ready for further tightening if needed.
- In the first quarterly inflation report of 2018, CB revised its 2018 year and inflation expectation from 7% to 7.9%. On the other hand, according to CB's survey, markets' year-end inflation expectations stands much higher at 9.6%. As the cost side factors continue to push inflation up, we see upward risks to CB's inflation

External Sector



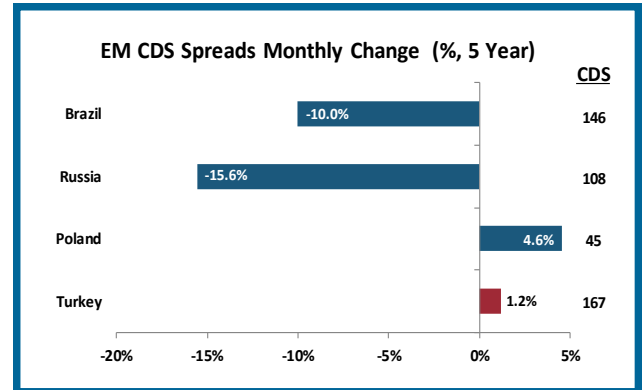
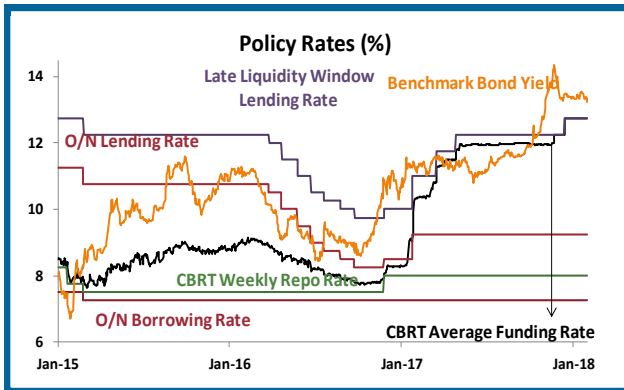
Current account deficit continued to widen with the upsurge in imports...

- In November, current account deficit (CAD) came at \$4.2 bn, slightly above the expectations. 12 month cumulative CAD widened to \$43.8 bn (5.1% of GDP) from \$41.8 bn (4.9% of GDP) one month ago. Portfolio inflows reached \$22 bn annually and became the main source of CAD financing in 2017.
- In November, annualized current account balance excluding energy and gold, which had improved significantly in the first 8 months of the year, gave a deficit of \$2.7 bn. Energy and gold imports continued to put an upward pressure on CAD. The annualized energy deficit went up YoY by 31% to \$31.6 bn while annualized net gold imports reached \$9.5bn. On the other hand, annualized tourism revenues were up YoY by 36% reaching \$17.8 bn, partly compensating the increase in trade deficit.
- In December, annual trade balance gave the largest deficit of last 4 years, indicating CAD continued to widen. In 2018, with an improvement in gold balance and higher exports, we expect CAD to increase moderately while CAD to GDP ratio remains at manageable levels around 5.5%.

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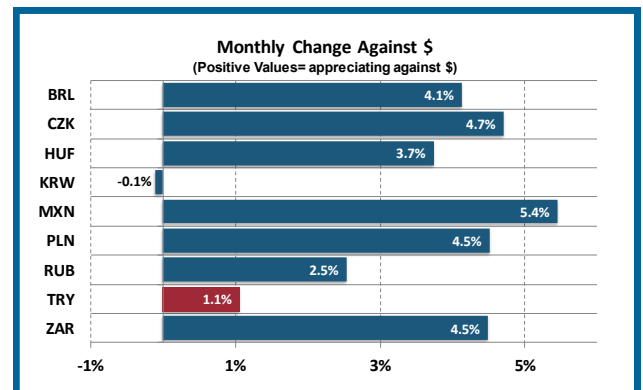
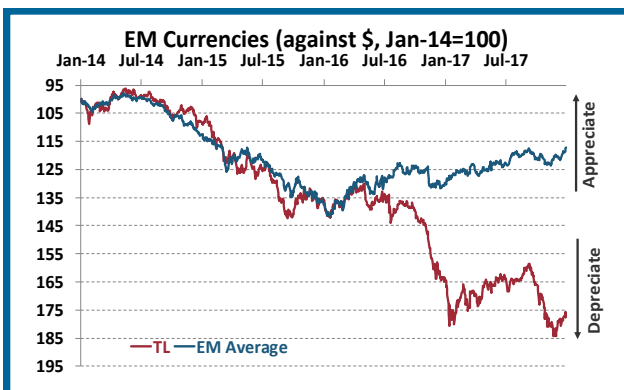
Financial Markets

Debt Market



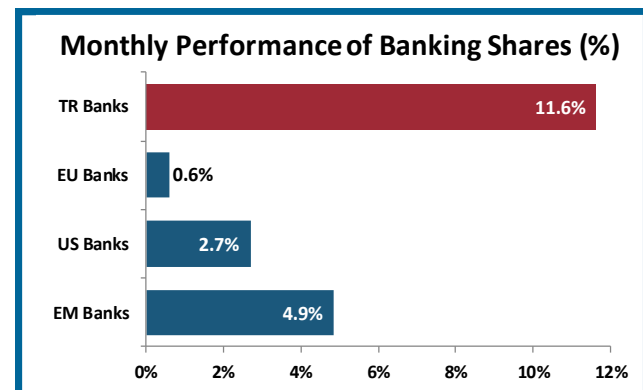
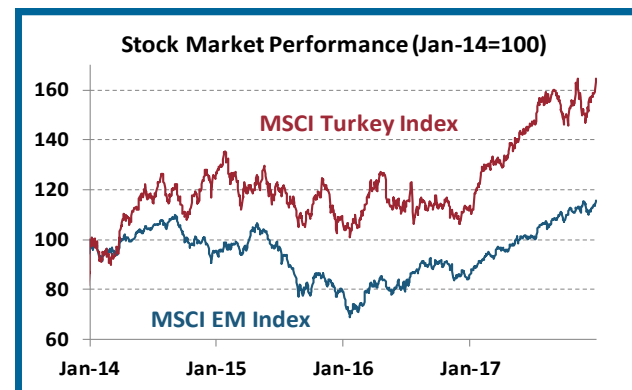
As the end of January, Turkey's 2-year benchmark bond yield is at 13.1%.

Currency Market



In January, TL and other EM currencies appreciated against USD.

Stock Market

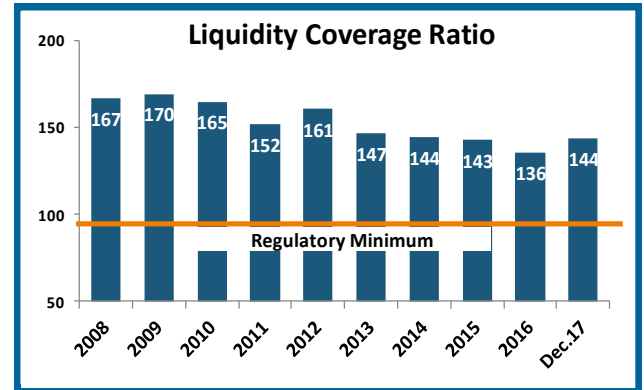
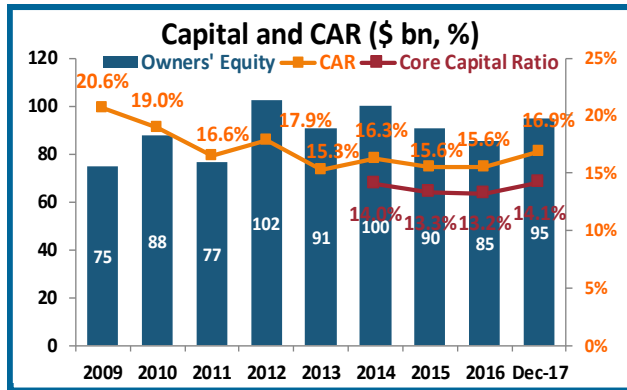


In January, EM stock market indices continued to increase. MSCI Turkey Index was up MoM by 3.1% while MSCI EM Index was up by 9.1%.

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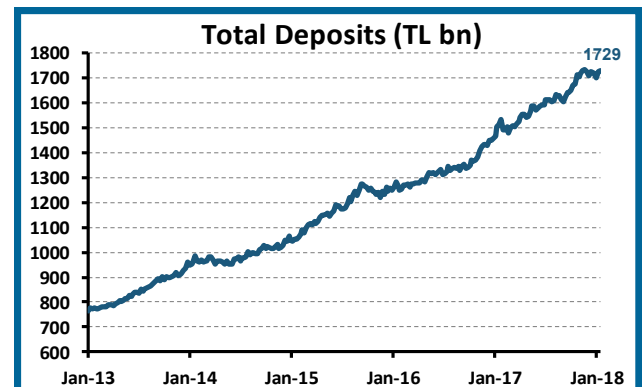
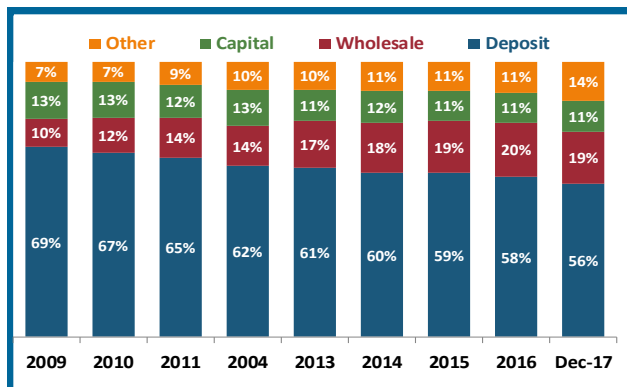
Banking Sector (I)

Capital



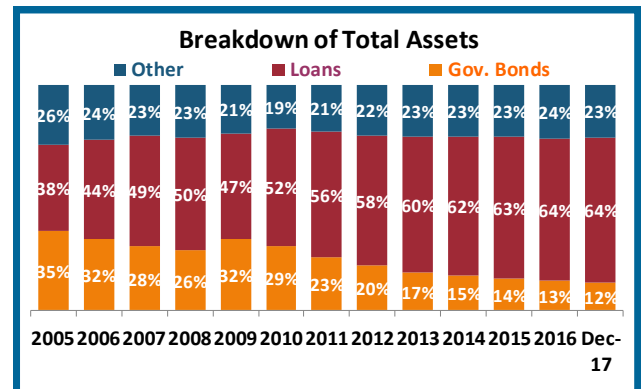
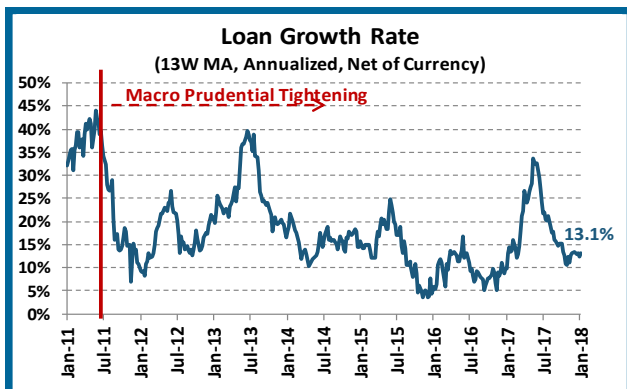
Turkish banking sector CAR rose to 16.9% in 2017.

Funding



Deposits were up YoY by 15% to TL 1.73 trillion as of Jan 19th. Share of deposits in funding was 56%.

Lending

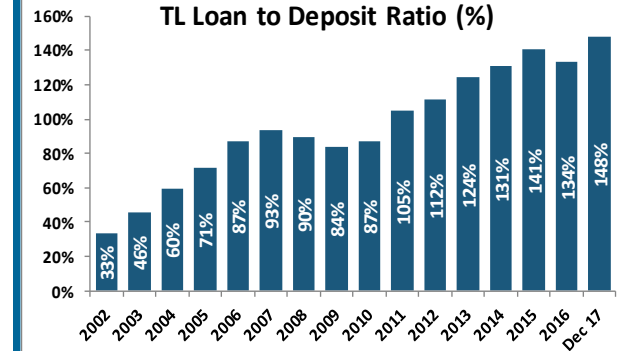
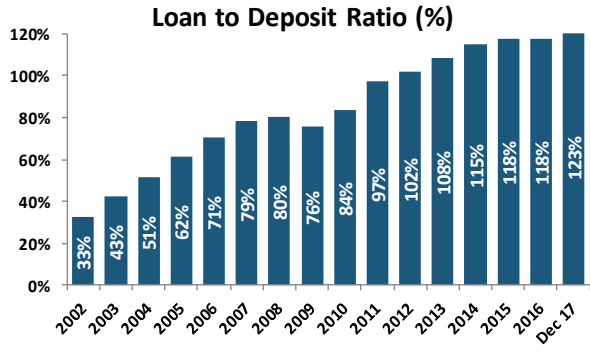


Annualized loan growth was stable at 13.1% as of Jan 19th.

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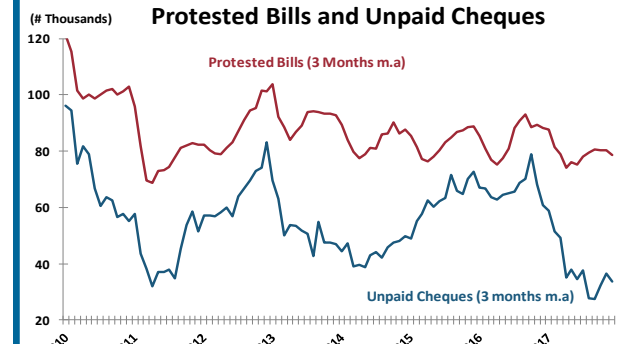
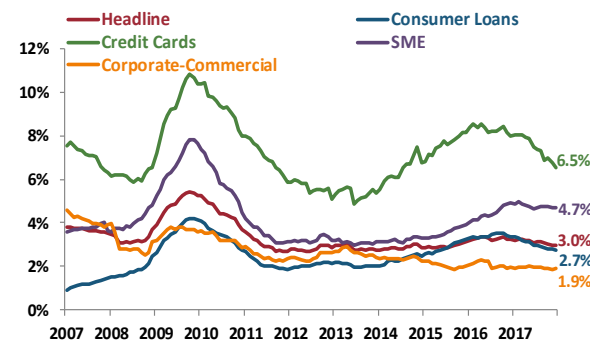
Banking Sector (II)

Loan to Deposit Ratios



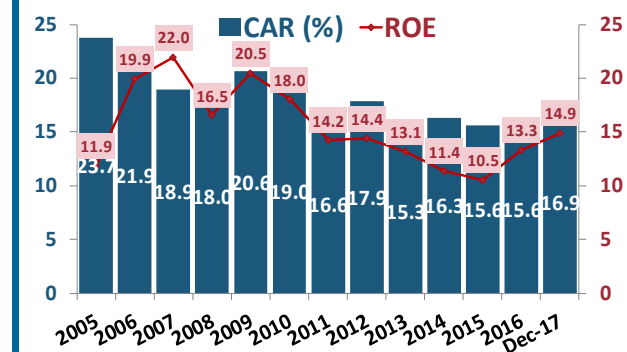
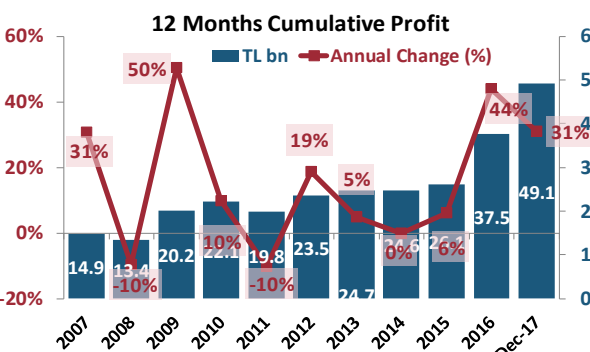
By the end of 2017, loan to deposit ratio (LDR) rose to 123% while TL LDR rose to 148%.

Loan Quality



Headline NPL ratio for the sector remained stable at 3.0%.

P & L



In December 17, banking sector's annual profit increased YoY by 31% to TL 49 bn and ROE went up to 14.9%.