DenizBank Economic Update

March 2017

- Economy
- Financial Markets
- Banking Sector

Economic Research and Strategy
Saruhan Özel, Ph.D.
Ezgi Gülbaş
Orhan Kaya
Deniz Bayram

© 2016 DenizBank. The opinions in this report were based on information available to the public which we consider reliable. Hence DenizBank assumes no consequential liability if they lead to investment decisions. The report is monthly and sent to a limited number of clientele. Reproduction in any form with no permission is prohibited. The report is not intended to be distributed in the United States of America; hence all kinds of reproduction and distribution in the United States of America is strictly prohibited.
DenizBank Economic Research – (90) 212 348 20 00 or ekonomikarastirmalar@denizbank.com
Turkish economy grew by 2.9% in 2016...

- GDP growth in 4th quarter of 2016 beat estimates (1.9%) with 3.5%. Growth in second quarter was revised up to 5.3% from 4.5%. Contraction in 3Q was revised as 1.3% from 1.8%. This brought 2016 full year growth to 2.9%. Seasonally and calendar adjusted QoQ GDP growth accelerated to 3.8% following 2.1% contraction in Q316.

- Household consumption recovered in 4Q16 as it grew by 5.7%. Exports increased by 2.3%, after contracting in the last two quarters and imports grew by 3.3%. Total investments growth accelerated to 2% from 0.5%, driven mainly by investments in construction sector. Growth in last quarter was observed in all sectors. In full year only 2 out of 13 sectors did not grow. Agriculture and services contracted by 4.1% and 0.8% respectively. The slowdown in tourism took a toll on services sector.

- The surge in economic activity was driven by a pick up in household consumption. Looking at the trend in retail loan growth in 1Q17, household consumption looks likely to continue growing. Private sector expenditure may increase driven by incentive programs. Exports, driven by the pick up in Euro zone economy, may continue to increase as well, pushing growth further in 2017. Our 2017 GDP growth expectation is 3.2%.

Inflation jumped to double digits in February, upward trend may continue...

- CPI in February increased MoM by 0.81%, above the market expectation of 0.48%. Food prices increased by 0.84% bringing annual food inflation up to 7.8% from 5.7% a month ago.

- Annual inflation went up to 10.13% from 9.22% a month ago. Core inflation continued to increase. Core inflation indicators B (CPI excluding unprocessed food, energy, alcoholic beverages, tobacco, gold) and C (CPI excluding food, energy, non-alcoholic and alcoholic beverages, tobacco, gold) rose by 8.27% and 8.56% respectively. Producers’ price index continued to rise as well and annual producer price increase reached 15.36%.

- CBT’s March rate decision statement suggests that the increase in inflation was driven by volatility in food prices and cost push pressures. The latent affects of currency depreciation between November 2016 and January 2017 has not kicked in yet. Furthermore, base effect may drive food inflation higher. This signals that inflation may increase further in the coming months. In the second half of the year, trend in inflation may turn downward as TRY volatility has been relatively low since February. Efforts to bring food prices down by Food Committee may help bring inflation down, as well.
Central Bank of Turkey (CBT) continues to tighten via Late Liquidity Window (LLW)...

- In its March meeting CBT kept weekly repo, O/N lending and borrowing rates unchanged at 8.0%, 9.25% and 7.25% respectively. The bank hiked LLW lending rate by 75 bps to 11.75%.

- In an attempt to bring down inflation and exchange rate volatility, the bank has tightened its monetary policy by hiking average funding rate to 11.33% in March from 8.31% at the end of 2016. In the March rate decision statement, CBT once again indicated that until inflation outlook improves significantly, tight monetary stance will be maintained.

- CBT’s commitment to bring inflation down is apparent from the way the average funding rate has gone up by more than 300 bps since the beginning of the year. As emerging markets have been facing increasing volatility especially since November, the bank also regressed to using an interest rate corridor, which is currently wider with the active usage of LLW lending rate. Such a policy toolkit creates more flexibility for monetary policy than a simplified interest rate policy would. As the bank signaled that the upward trend in inflation may continue in coming months, average funding rate may increase further.

External Sector

- Annual current deficit expanded slightly, as positive contribution from energy deficit reversed..

  - Current account deficit (CAD) in January was in line with expectations at $2.8 bn. 12 month cumulative CAD which was $32.6 bn in December, rose to $33.2 bn.

  - On the financing side, there has been an FDI inflow of $0.4 bn in January and net portfolio inflow of $1.6 bn, thanks to government’s bond issue of $2 bn in international markets. Reserve assets decreased by $2.1 bn and there has been an outflow of $0.7 bn in net errors and omissions. 12 month cumulative energy deficit went up to $24.6 bn from $23.9 bn a month ago. Annual tourism revenues dropped YoY by 34% to $13.8 bn.

  - In 2017, rise in energy prices might marginally cause CAD to increase. With a limited recovery in tourism revenues and better export performance due to competitive currency and pick-up in Eurozone economy, CAD to GDP ratio could be close to 5%. 
2-year benchmark bond yield is at 11.3%.

EM currencies depreciated slightly against USD on average.

EM equity markets performed positively in March.
CAR increased to 15.9% in Feb ‘17.

Share of deposits in funding was at 56% as of Feb 17.

Annualized loan growth is at 14.6% as of March 17th.
Loan to deposit ratio is 119% in February.

Headline NPL ratio for the sector is at 3.3% as of Feb 17.

In Feb 17, banking sector’s annual profit increased YoY by 53% while ROE reached 14.2%.