

DenizBank Economic Update

December 2017

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

Economic Research and Strategy

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Deniz Bayram

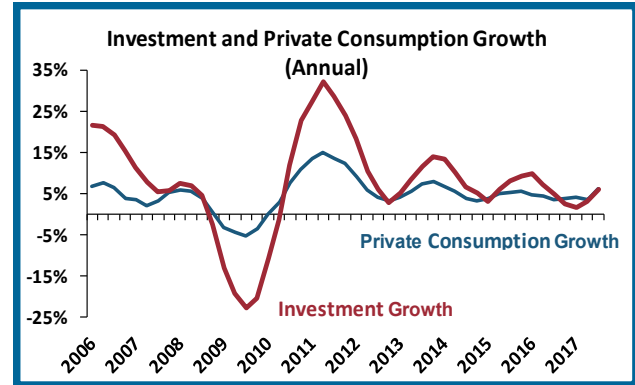
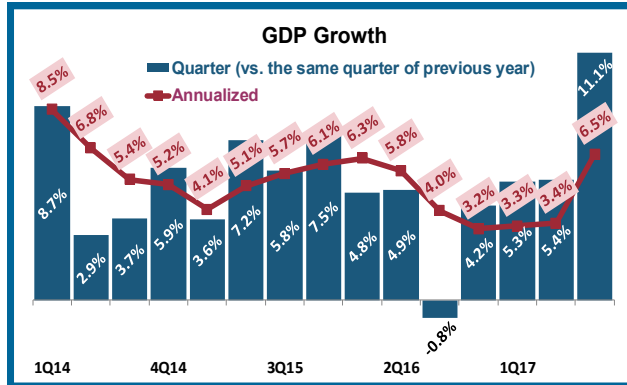
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DenizBank Economic Update

Economy (I)

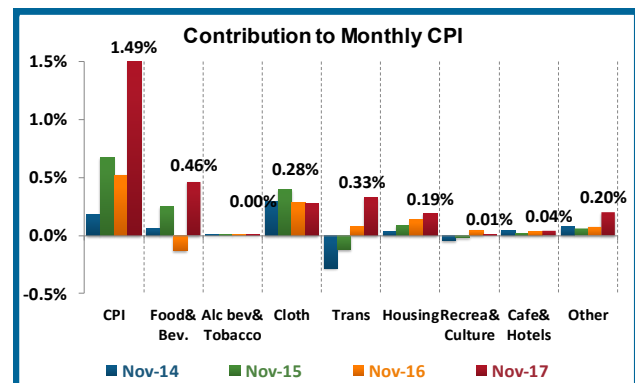
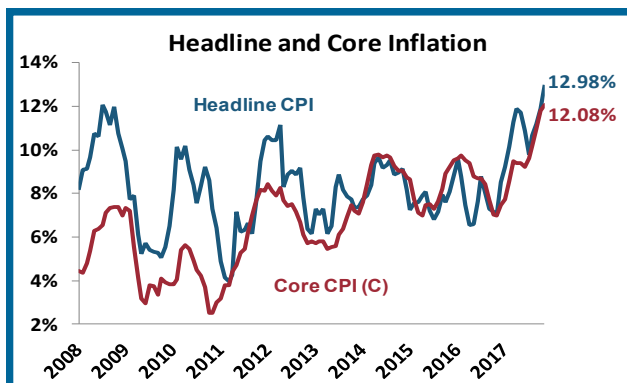
Growth



Growth accelerated further in 3Q17 with the support of strong base effect..

- In 3Q17, GDP expanded YoY by 11.1%, above market consensus of 8.5%. Strong GDP growth was driven by favorable base effects and the ongoing impacts of the stimulus measures. On the other hand, seasonally and calendar adjusted QoQ growth rate moderated to 1.2% from 2.2% in 2Q17.
- Private consumption and investments were the main drivers of the growth as both increased at double digits. Private consumption and investments' contribution to headline growth was 7.0 percentage points (pp) and 3.6pp, respectively. Government consumption contributed 0.3pp to the headline growth. The contribution from net exports was also limited 0.3 pp as solid growth in exports (YoY by 17.2%) was partially offset by the expansion in imports (YoY by 14.5%).
- October industrial production (YoY by 8.9%) and other preliminary indicators (PMI, capacity utilization) show that economic activity is still strong in 4Q17. Nevertheless, the surge in imports signals that the contribution of net exports may turn to negative. Also as fiscal incentives (i.e. tax cuts) expired and credit stimulus reached its limits, growth could moderate in 4Q17 but we expect 2017 overall growth rate to be strong at c.6.5%.

Inflation



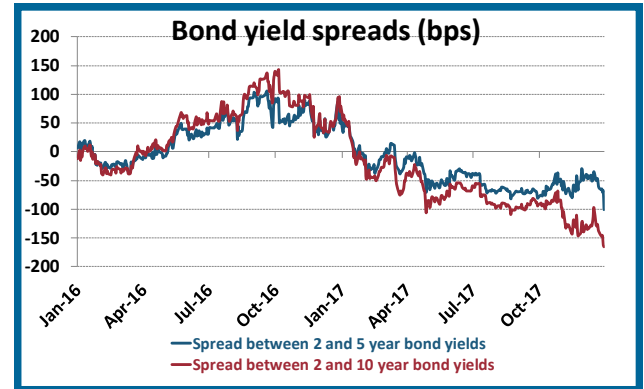
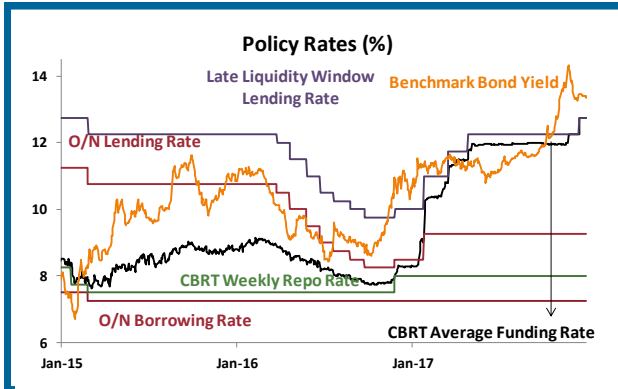
Currency depreciation and base effect continues to push inflation higher...

- In November, CPI increased MoM by 1.5%, above the market expectations of 1.1%. Higher-than-expected CPI was mainly driven by sharp increases in food and transportation prices. Food prices increased MoM by 2.1% contributing 0.46 pp to the monthly CPI. Transportation prices increased by 2.0% due to higher global energy prices and weaker TL.
- Annual inflation jumped to 13% from 11.9% a month ago, its highest level since 2003. The deterioration in the inflation outlook is not only due to food and energy prices, as core inflation (CPI excluding food, energy, non-alcoholic and alcoholic beverages, tobacco, gold) remains elevated at 12.1%. Annual producers' price inflation is also high at 17.3%.
- Inflation will start a downward trend as the favorable base effect kicks in from December. However, given the depreciation in currency and deterioration in the core inflation and producer prices, we expect the downward movement to be limited and transient. Our 2017 year-end inflation forecasts stands at 11.4%. 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)

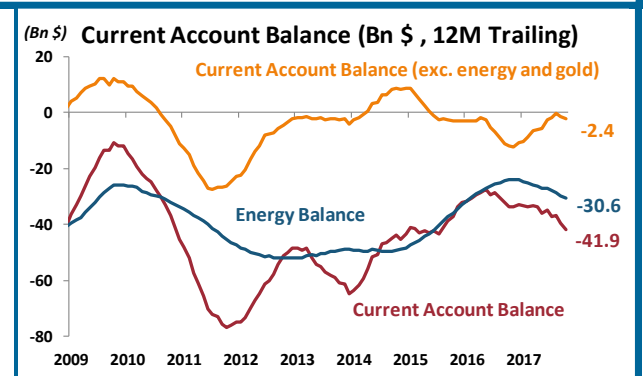
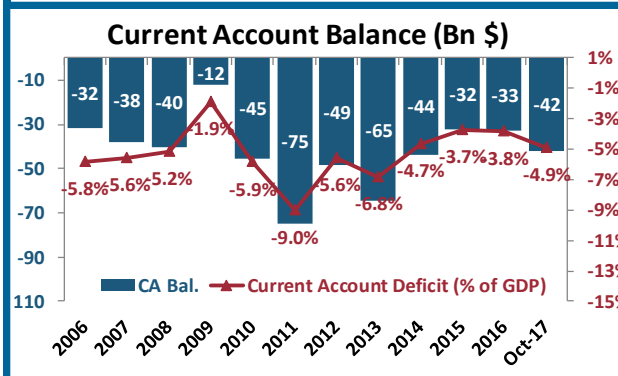
Monetary Policy



Central Bank of Turkey increased the average funding rate by 50 bps and stressed commitment to a tight monetary policy stance until inflation outlook improves significantly...

- Central Bank (CB) increased its late liquidity window (LLW) rate by 50 bps to 12.75% in December meeting, below the market expectations of 100 bps shaped upon the depreciation in TL and elevated inflation print in November. CB kept the policy (8%), O/N lending (9.25%) and O/N borrowing (7.25%) rates unchanged. Following the meeting, CB continued to provide all funding through LLW rate and the average funding rate increased to 12.75%.
- Decision statement was mostly unchanged, except for the part remarking recent developments in cost factors as one of the reasons behind rising inflationary risks. CB continued to emphasize that tight monetary policy stance will be maintained until inflation outlook improves significantly.
- According to CB's December survey, year-end, 12m and 24m ahead inflation expectations are 11.7%, 9.3% and 8.5% respectively. Given the depreciation in TL and the anticipation that the downward trend in inflation due to base effect will be transient, we expect CBT to hold on a tight monetary policy in early 2018.

External Sector



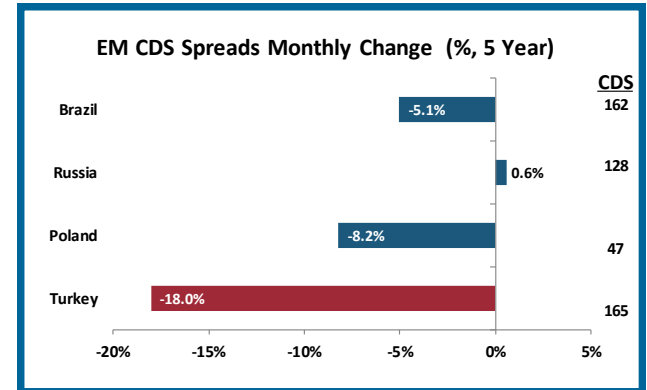
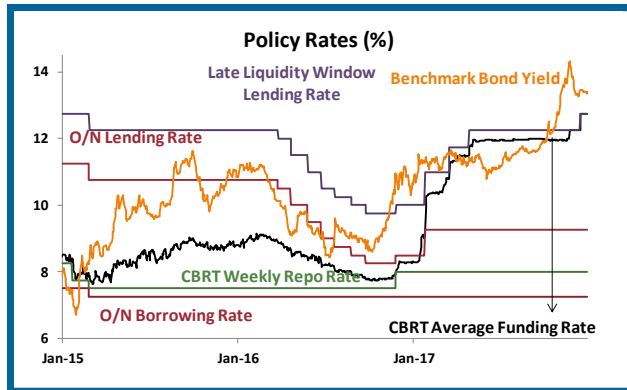
Current account deficit continues to widen with the upsurge in imports...

- In October, current account deficit (CAD) came at 3.8bn, in line with the expectations. 12 month cumulative CAD widened to \$41.9 bn (4.9% of GDP) from \$39.7 bn (4.7% of GDP) one month ago. Portfolio inflows reached \$21 bn annually and were the main source of financing the deficit in 2017.
- In October, annualized current account balance excluding energy and gold, which has improved significantly in the first 8 months of the year, gave a deficit of \$2.4 bn. Energy and gold imports continued to build an upward pressure on CAD. Annualized energy deficit widened to \$30.6 bn from \$29.7 bn while annualized net gold imports reached \$9bn. On the other hand, tourism revenues were up by 30% and 12 month cumulative tourism revenues increased to \$17.5 bn, partly compensating the increase in trade deficit.
- In November, annual trade deficit continued to widen, indicating CA deficit will continue to increase. Given the upward trend in imports supported by economic activity and higher energy prices, we expect CAD to GDP ratio to increase further by the end 2017 but stay at manageable levels, namely c.5.3%.

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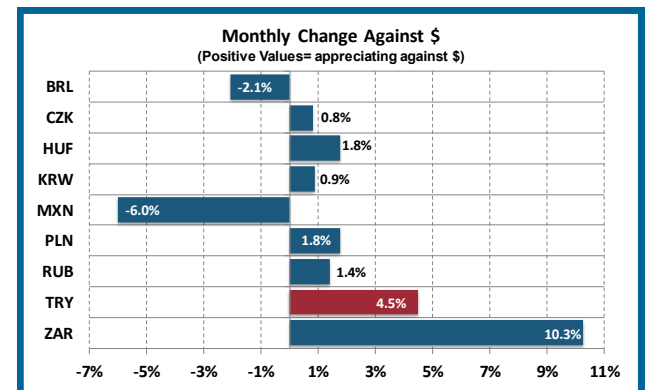
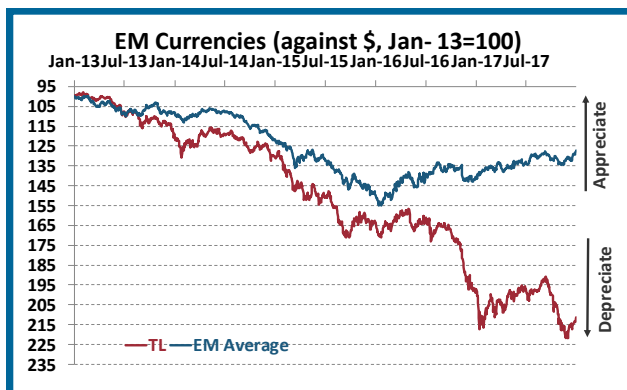
Financial Markets

Debt Market



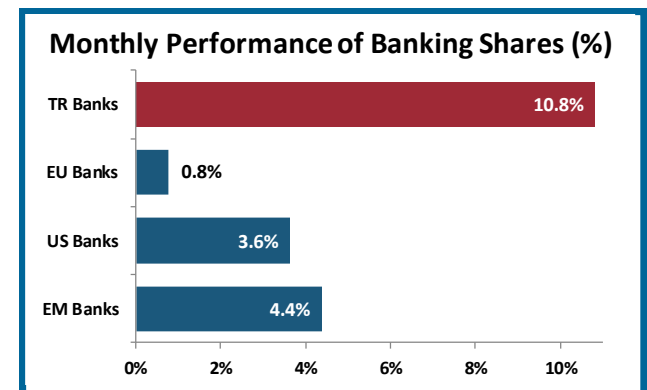
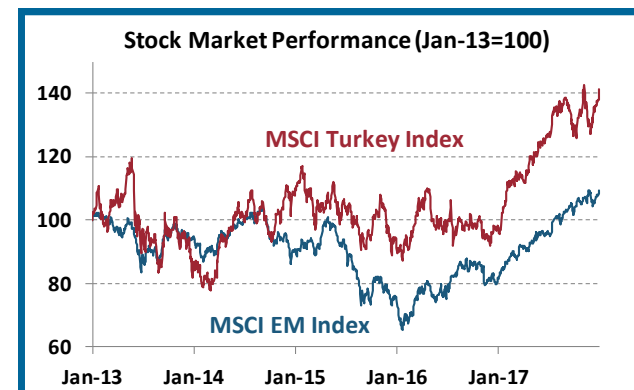
As the end of December, Turkey's 2-year benchmark bond yield is at 13.4%. Turkey's CDS is down MoM by 18% to 165.

Currency Market



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

Stock Market

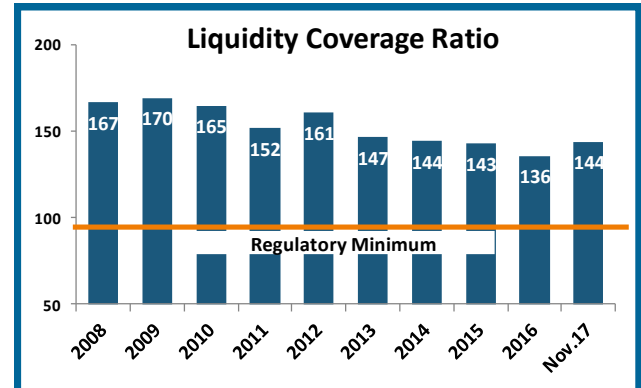
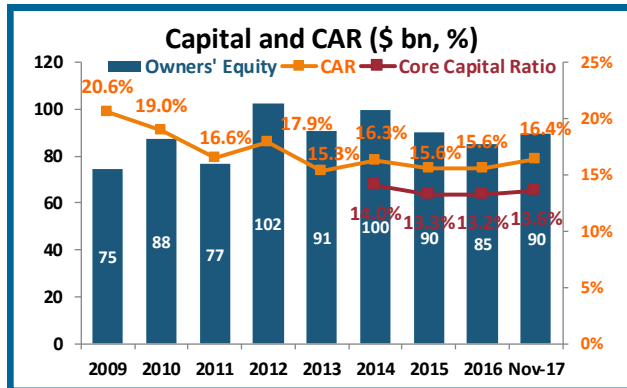


In December, EM stock markets continued to increase. MSCI Turkey Index was up MoM by 9% after a decline in November.

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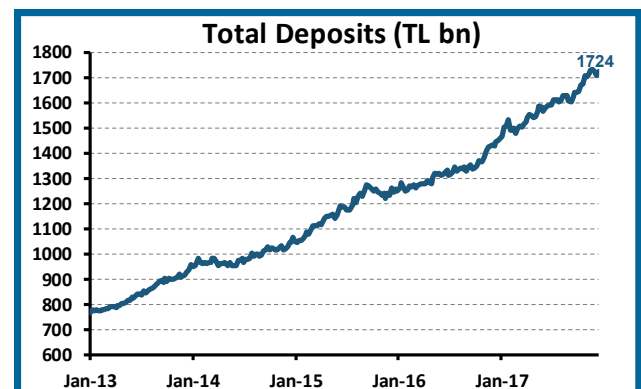
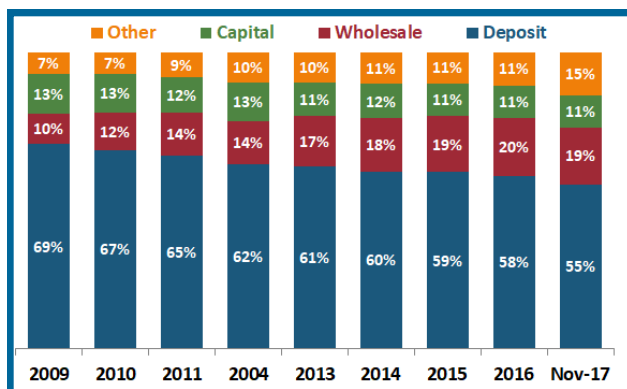
Banking Sector (I)

Capital



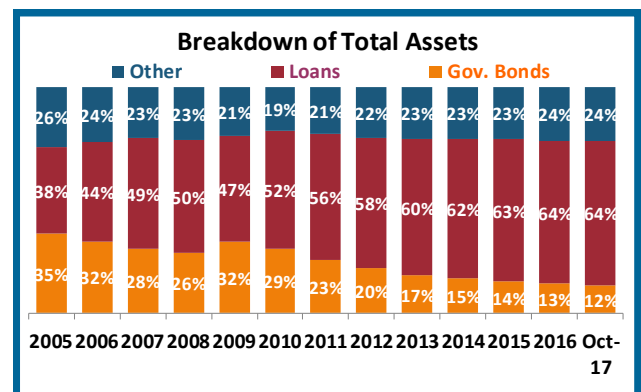
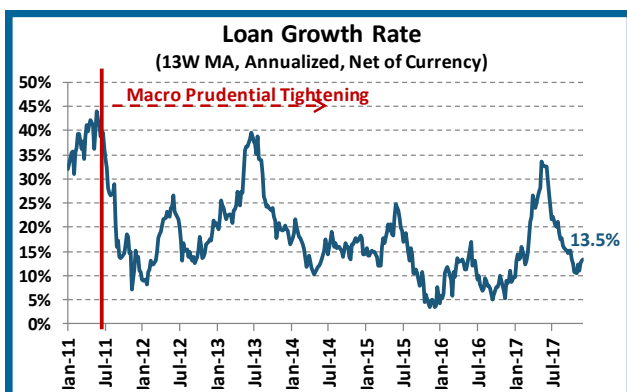
Turkish banking sector CAR was at 16.4% in November.

Funding



Deposits were up YoY by 19% to TL 1.72 trillion as of Dec 15th. Share of deposits in funding was 55%.

Lending

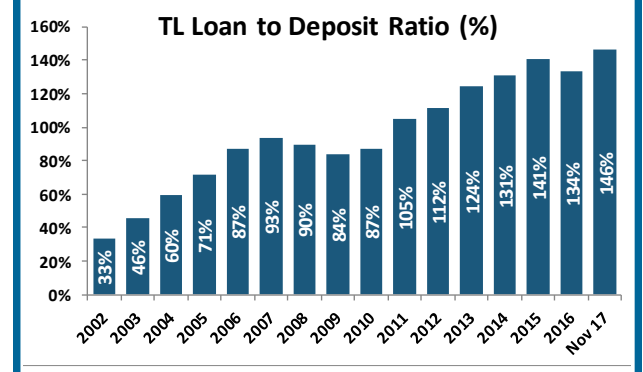
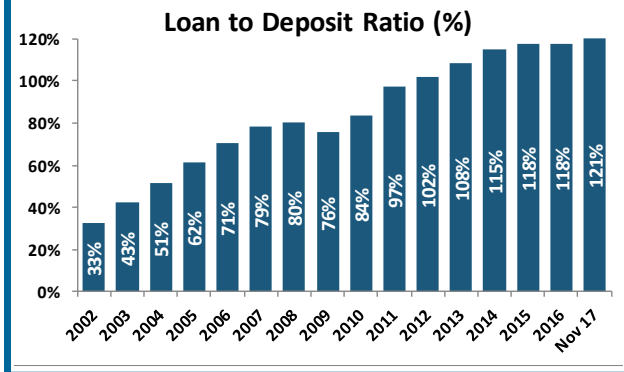


Annualized loan growth was at 13.5% as of Dec 15th.

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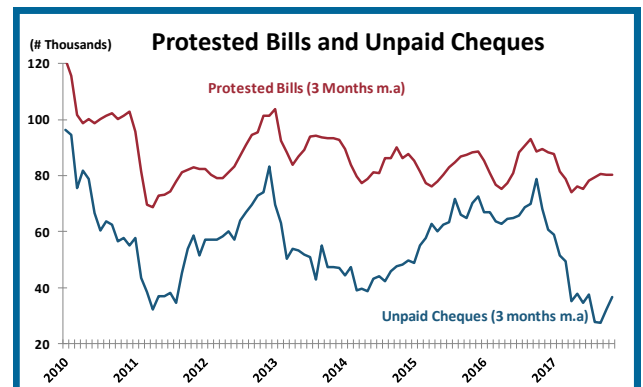
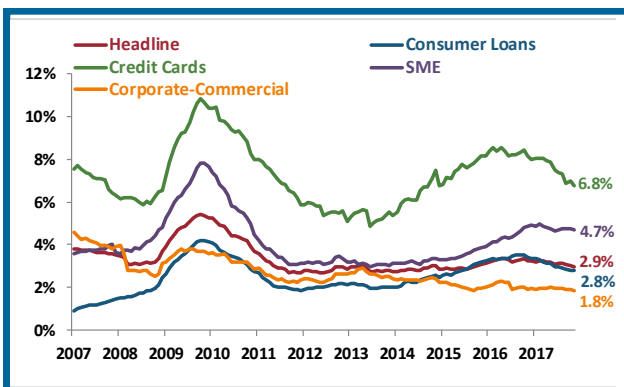
Banking Sector (II)

Loan to Deposit Ratios



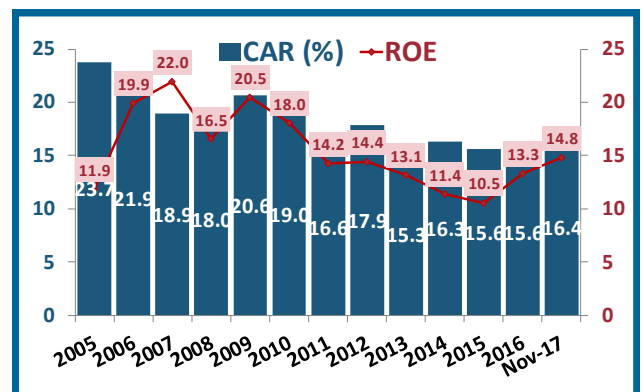
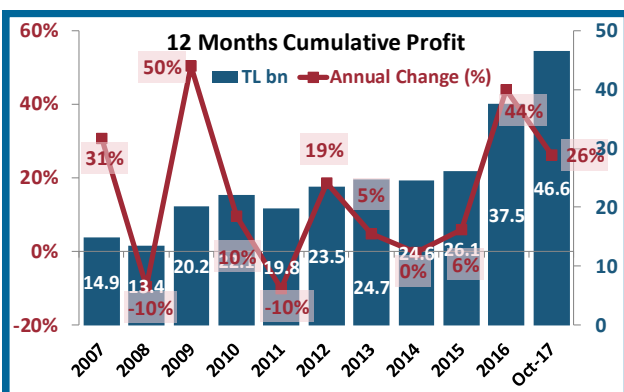
By the end of November, loan to deposit ratio (LDR) was at 121% while TL LDR was at 144%.

Loan Quality



Headline NPL ratio for the sector remained stable at 2.9%.

P & L



In November, banking sector's annual profit increased YoY by 26% to TL 47 bn and ROE went up to 14.8%.