

DenizBank Economic Update

February 2019

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

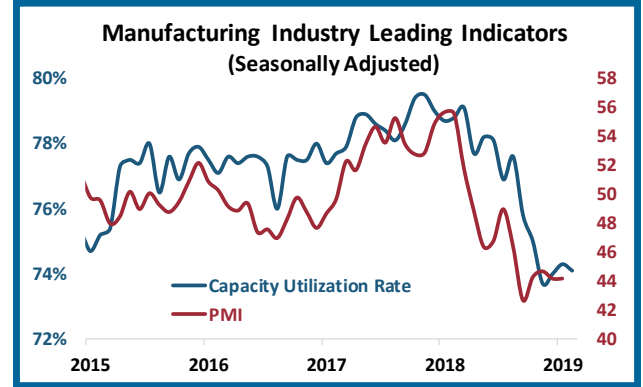
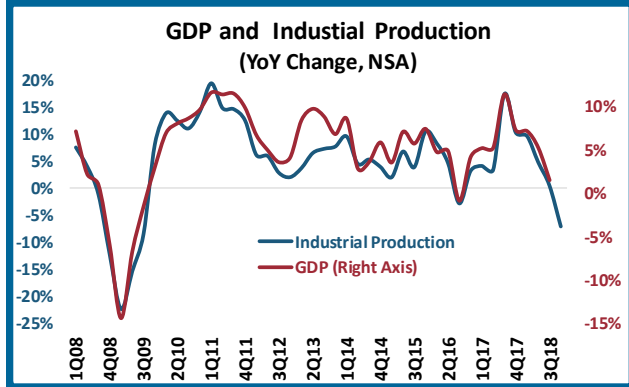


DenizBank Economic Research and Strategy

DenizBank Economic Update

Economy (I)

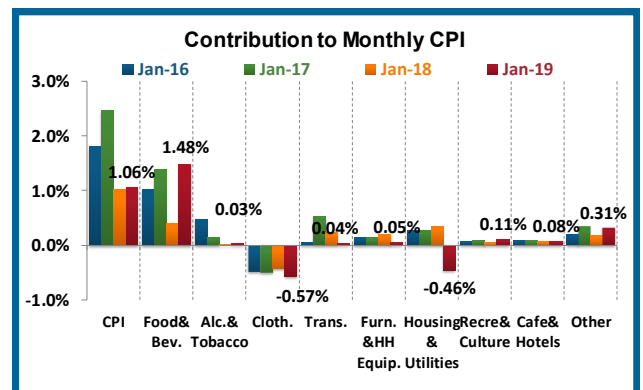
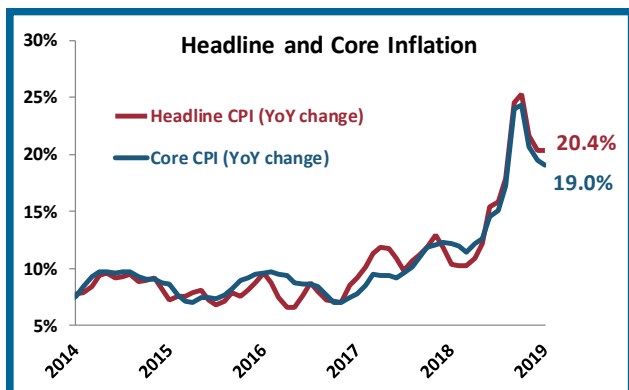
Growth



Preliminary data signals contraction in economic activity in 1Q19

- Industrial production surprised to downside in December with an annual decline of 9.8%, sharpest decline since June 2009. As a result, industrial production decreased by 7% YoY in the last quarter of 2018, accompanying a 7.4% drop in retail sales. Following a sluggish third quarter, these two indicators signal a c.4% YoY contraction in GDP in 4Q18 which would drag 2018 full-year growth rate down to 2.2%.
- Moreover, preliminary indicators suggest that contraction in economic activity continues in similar pace in 1Q19. PMI manufacturing index remained unchanged at 44.2% in January while capacity utilization rate declined to 74.1% in February, its 9-year low 4Q18 levels. Sharp decline in housing (-25%), auto (-59%) and white good (-13%) sales together with 34% decline in consumption good imports and 23% real decline in indirect tax revenues demonstrates the plunge in domestic demand.
- Contraction in domestic credit continues with tight monetary conditions. We expect consumption and investment growth to remain in negative territory in 1H19, before turning positive in the 2H19 with the help of lower interest rates and favorable base effect.

Inflation



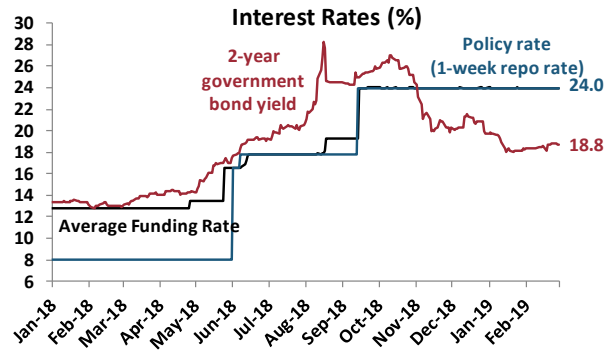
Annual inflation remained flat at 20.4% in January

- Consumer prices increased MoM by 1.1% in January, in line with the market expectations. Sharp increase (6.9% MoM) in food prices due to poor weather conditions more than offset the administrative price cuts in utilities and seasonal decrease in clothing prices, ending the two consecutive months of disinflation.
- Annual inflation was little changed with January imprint at 20.4% (Dec'18: 20.3%). Downward trend in underlying inflation continued as core inflation decreased from 19.5% to 19.0%, thanks to stability in TL and in part weak domestic demand. In contrast, services price inflation accelerated from 14.5% to 15.4%, demonstrating that contraction in domestic demand has not entirely offset cost pressures. With producers' price inflation elevated at 33.6% annually and backward-indexation behavior in wages, cost-push pressures persist.
- We expect inflation to accelerate in the first four months of 2019 up to 22% in April (when expiration of tax cuts will add 1 pp to headline inflation), before starting a rapid downward trend in 3Q18 towards 12% with the support of favorable base effect. Our 2019 year-end inflation expectation is 15%.

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Economy (II)

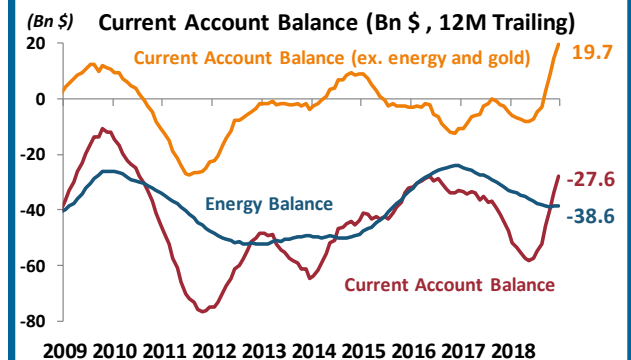
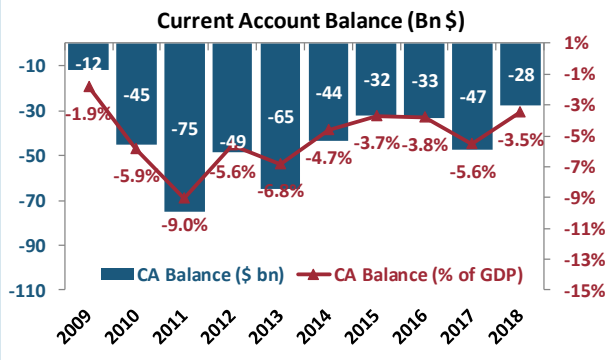
Monetary Policy



Central bank commits to tight monetary policy until inflation outlook improves significantly

- In February, Central Bank (CB) lowered TL reserve-ratio requirements by 100 bps for deposits with maturities up to 1-year (other liabilities with maturities up to 3-year), and by 50 bps for all other liabilities. Although additional liquidity provided to financial system by the decision will be relatively limited, it will support the recent pick-up in credit growth.
- Yet, CB Governor Cetinkaya had expressed that steps to manage liquidity in support of financial stability wouldn't signal a change in monetary policy stance. CB had kept the policy rate unchanged at 24% in January meeting. More importantly, in both meeting announcement note and January Inflation Report, CB reassured the markets against the prospect of a premature rate cut by keeping the hawkish policy guidance unchanged and preserving the tightening bias. CB reiterated that the tight monetary stance will be maintained until inflation outlook displays significant improvement and further tightening will be delivered if needed. Given the CB's undeterred policy guidance and elevated inflation expectations remaining above 20% in most of the 1H19, we expect CB to keep the policy rate on hold until June meeting.

External Sector



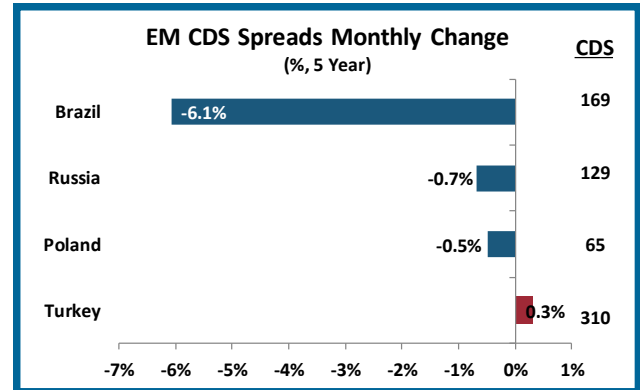
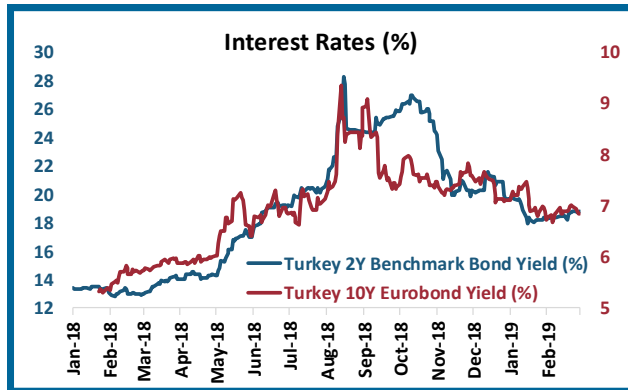
Current account deficit shrunk rapidly to 3.5% of GDP in 2018 and set to improve further in 2019

- Sharp slowdown in domestic demand combined with robust external demand and depreciation in the real exchange rate, led to a rapid improvement in external balances in second half of 2018. By the end of 2018 annual current account deficit (CAD) more than halved to \$27 bn (3.5% of GDP) from a peak of \$58 bn (7.3% of GDP) in May 2018, its lowest level since July 2010.
- As imports decreased by 20% (consumption goods: -39%) in 2H18 due to weak domestic demand, core CAD (exc. energy and gold) gave an all-time high \$20 bn (2.5% of GDP) annual surplus in 2018. Annual energy deficit remained stable at \$39 bn as prolonged deterioration in energy balance came to an end in last two months of 2018 with oil prices retreating below 60\$.
- In 2018, reserve drawdowns (\$10 bn annually) together with net errors and omissions (\$21 bn) have been the main source of CAD financing, while financial account recorded a capital outflow of \$4 bn for the first time since 2009. Portfolio outflows amounted to \$3 bn annually and banks' annual external debt roll-over ratios decreased to 76% with net debt repayments of \$15 bn.
- In January, trade deficit decreased further by \$6.5 bn with a sharp decrease in imports. As contraction in economic activity continues in 1H19 and oil prices remain below 2018 levels (2018 avg. Brent oil \$72/bbl) we expect CAD to decrease to 2.0-2.5% of GDP in 1H19.

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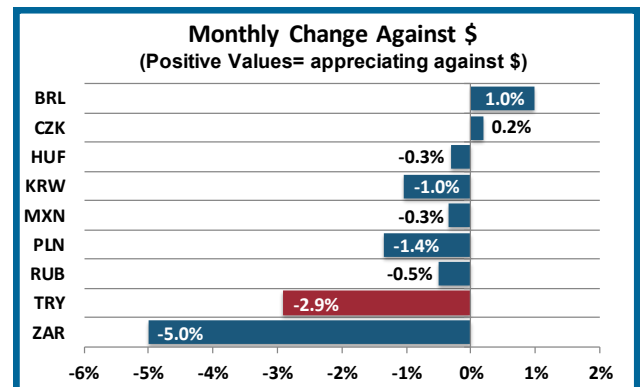
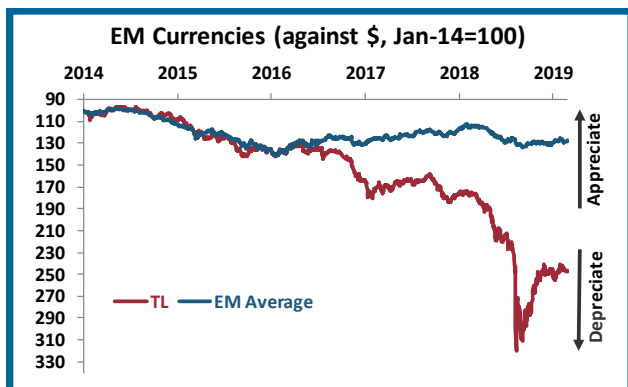
Financial Markets

Debt Market



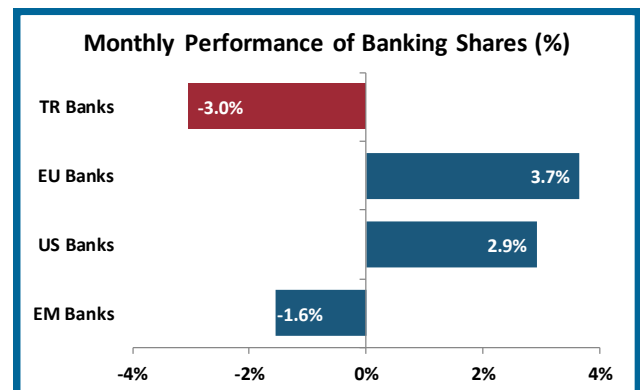
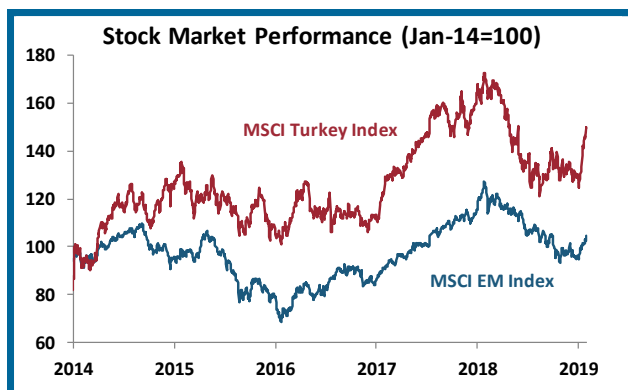
Turkey's funding cost remained roughly unchanged in the beginning of 2019, with two-year benchmark bond-yield at 18.8%.

Currency Market



Following a 28% sharp depreciation in 2018, TL remained flat against USD in first two months of 2019, in line with other EM currencies.

Stock Market

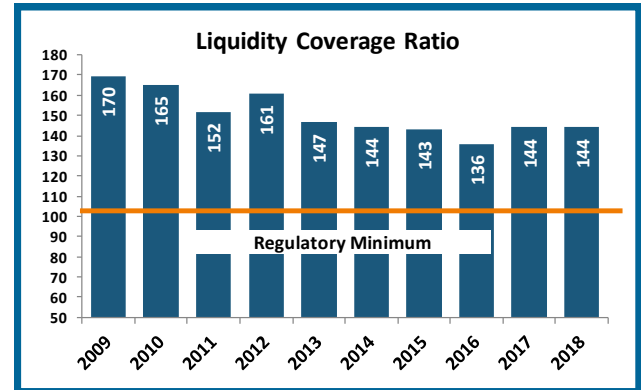
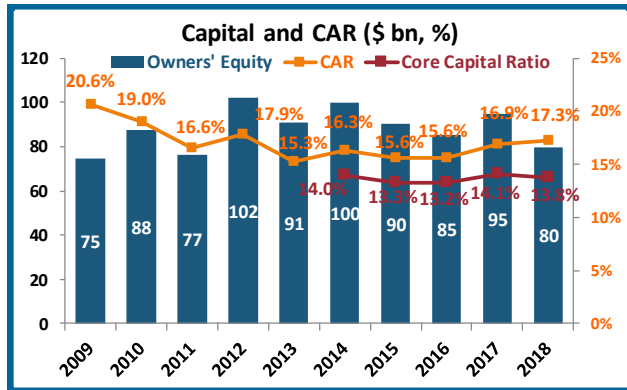


MSCI Turkey index was up YtD by 14% (in TL terms) in 2019, over performing other EM equity indices (MSCI EM index: +10%).

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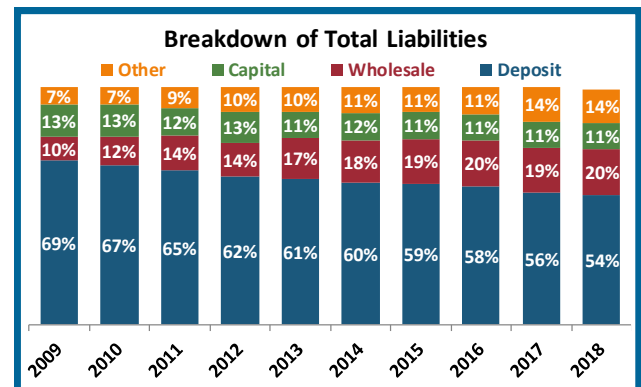
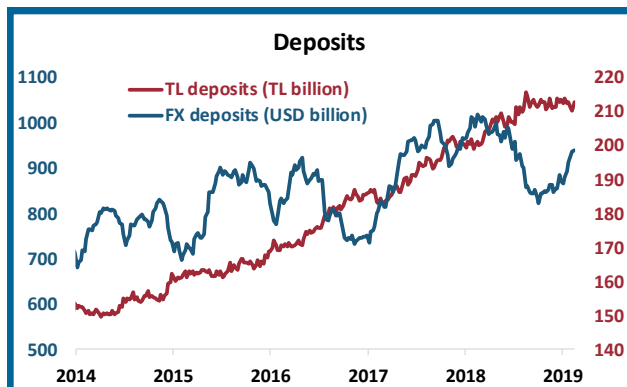
Banking Sector (I)

Capital



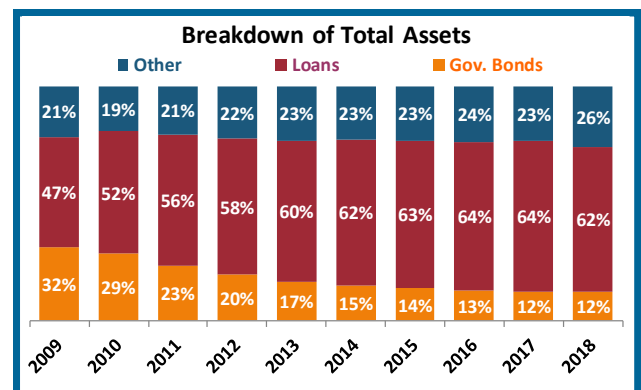
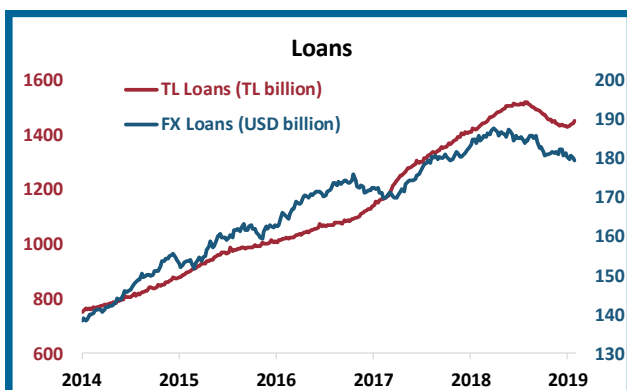
Turkish banking sector has a strong capital base. Capital Adequacy Ratio is at 17.3% as of 2018YE.

Funding



Deposits went up by 20% YoY (2.1% net-of-currency) to TL 2.1 trillion in Feb'19.

Lending

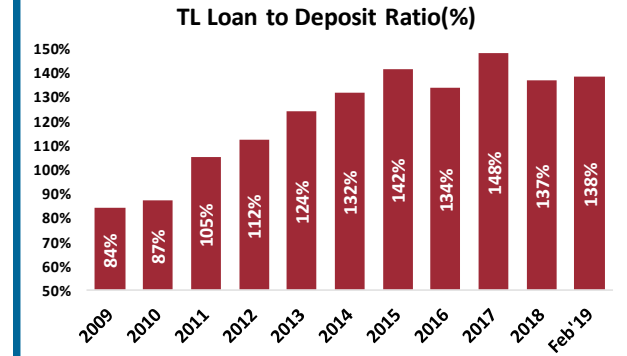
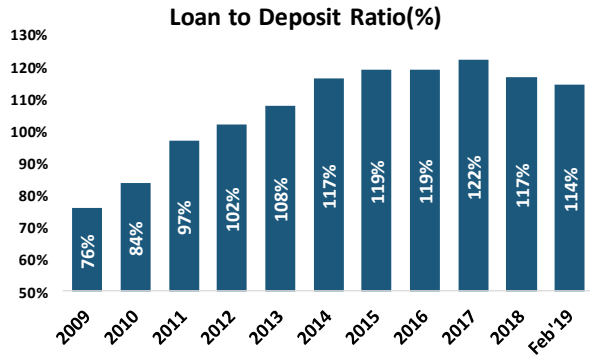


Loans contracted 0.5% YoY (net-of-currency) to TL 2.4 trillion in Feb'19.

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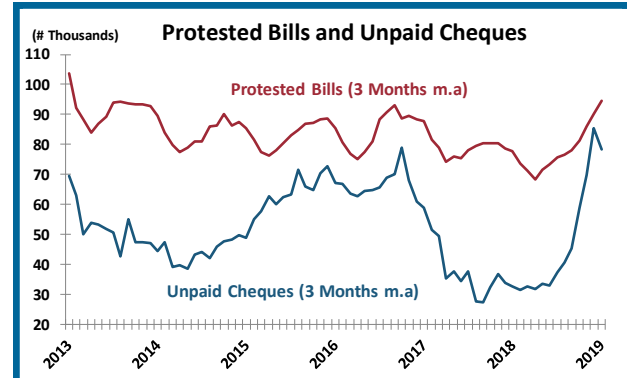
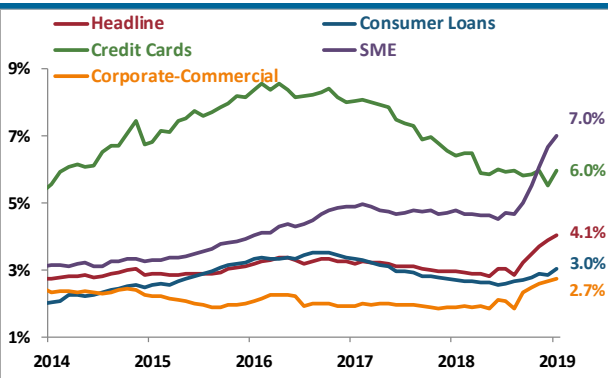
Banking Sector (II)

Loan to Deposit Ratios



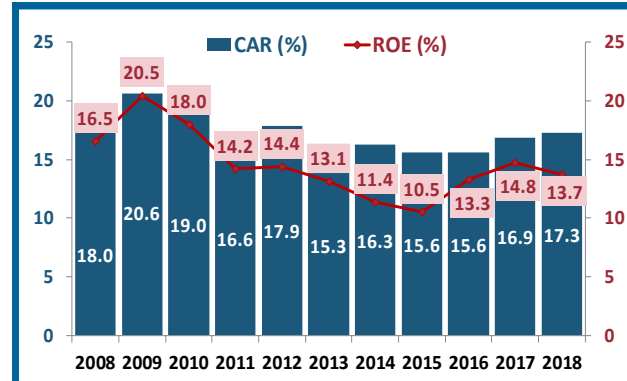
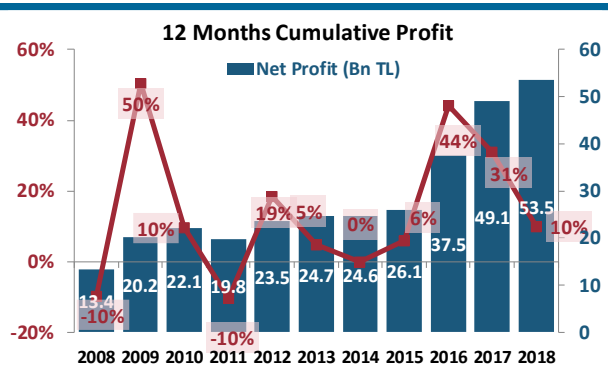
Loan to deposit ratio (LDR) and TL LDR decreased to 114% and 138%, respectively.

Loan Quality



Headline NPL ratio for the banking sector rose moderately to 4.1% by Feb'19.

P & L



Banking sector's profit increased YoY by 10% to TL 54bn in 2018. RoE of the sector decreased to 13.7%.